Marketing of Real Estate

by

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A DISSERTATION

Presented to the

Economic Scientific Faculty at the University of Oradea

in Partial Fulfillment of Requirements for the Degree of

Doctor of Philosophy

Under the Supervision of Professor Dr. M. C. Demetrescu

Oradea, Romania

October, 2001

Abstract

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This dissertation investigates the relationship between the various taxes imposed upon the landlords of land and buildings as well as upon buyers, sellers and users of real estate, and the marketing methods of real estate via tax shelters and anonymity.

A theory asserting that this relationship is targeted to the inherited resistance in human culture to pay taxes to the rulers - kings or democratic governments, without breaching the law. While tax evasion is illegal, tax avoiding is legitimate legally and socially.

In order to understand the inherited resistance in human culture to pay taxes to the rulers, one should learn the phenomenon of the role of land for human kind. The concepts of rent and land taxation nowadays as well as in previous centuries should be discussed. The growth of population impact on the land use and the evolving of cities and mega-cities should be investigated. This dissertation tries to compete with all this tasks.

The empirical results confirm the theory's hypotheses. Because anyone would prefer to avoid paying taxes and some would prefer to become an anonymous owner of real estate assets, it creates the need for investigating and developing marketing methods of real estate via tax shelters and anonymity.

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ACKNOWLEDGMENT

A superb adviser and a scientific guide Professor Dr. M. C. Demetrescu supervised this research. Professor Demetrescu has played many rolls. During the last five years he became a supporting friend, a helpful instructor, a catalyst to fulfil the academic obligations, a wonderful teacher, and finally a mentor.

I met Professor Demetrescu in a hotel in Oradea where we accommodate while he lives in Bucharest and I live in Israel. My introduction to the marketing world started at that hotel since I practice law and specializing in land-law and taxation-law. Professor Demetrescu became my bridge to the Economic Scientific Faculty at the University of Oradea and helped me to overcome the Romanian language obstacle.

Thanks to my partner at my law office in Israel, Pinhas Gilad, who carried the burden during my visits to Romania and my absence during learning and writing this dissertation.

Last but not least to be thanked is my wife Jehudit and our three kids Etgar, Oryan and Nefertiti who supported me all the way along. This degree is the product of that entire environment.

Chapter 1 Introduction

Real estate is man's single most expensive requirement in life, and purchasing this asset requires the savings of many years of labour. Real estate can be used as both a habitat and a livelihood.

In addition to the economic value of a man's house, there is also an emotional value attached to it. The instinct to guard one's own territory is a basic instinct that applies to fish, amphibians, reptiles, birds and mammals. Similar to the instinct in animals, the territorial instinct is the strongest of man's instincts, and he is ready to sacrifice his own life in protection of his territory.[1]

As recently as 10,000 years ago, people gathered into small Neolithic settlements. There were from five to 10 million human beings then - not enough to exercise much influence on the ecosystem within which they lived and worked. That situation prevailed for the most of the next 10,000 years. Only in the last few decades have humans brought about changes comparable in magnitude to those wrought by nature during long epochs of geological time.[2]

The complex of developments in stone tool technology, food production and storage, and social organization that is often characterized as the Neolithic

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1 Ardrey, Robert. African Genesis A Personal Investigation into the Animal Origins and Nature of Man, Dell Publishing, 1961.

2 Keyfitz, Nathan. "The Growing Human Population", in Managing Planet Earth: readings from Scientific American magazine, W. H. Freeman and Company, New York, 1990, p. 61. See chapter 3.4.

revolution was in progress in China by at least the 6th millennium BC. Developments in the Chinese Neolithic were to establish some of the major cultural dimensions of the subsequent Bronze Age.[3]

The perpetual growth in the world's population[4] decreases the amount of land per person[5] and, as a result, increases the value of the existing land. Today, more man-hours are required to purchase an average apartment, or house. The process of increasing the value of land is destined to continue as long as there is an increase in the number of consumers interested in purchasing a "product" which is impossible to create - *Land*. The phenomenon of continuous growth in the value of land is especially true in cities, although there is also an influence on the value of land in outlying areas, where there is more available land to be populated.

The trend of growing population leaves less land per person and causes elevation prices of land. Since the industrial revolution people move from the country to the cities, and it causes the trend of the high prices of the land in the growing cities. I discuss these trends through the history of man and land.

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3 Encyclopædia Britannica, China, history, prehistory, Neolithic period, http://www.britannica.com/eb/article?eu=127710&tocid=71613. It is now thought that the first human inhabitants of Asia migrated into the continent from Africa at least one million years ago. The earliest traces of human activity in Asia are associated with the Homo erectus fossils found at Zhoukoudian near Peking. Encyclopædia Britannica, Asian people, http://www.britannica.com/eb/article?eu=118213&tocid=65114

4 In 1998 the population was 6,000,000,000 while only 200 years ago the population was about 600,000,000. U.S.A Census Bureau - The official statistics, data of historical population in the world, http://www.census.gov/ipc/www/worldhis.html

5 "Having developed technologies that transformed the earth, humankind now wonders about whether the planet and its resources can continue to sustain life. But the author sees that several modern technological trends are leading us toward a better, not worse, environmental future. He notes that we are using energy and land with increasing efficiency, and suggests that these trends may make human existence, even with population growth, less of a burden to the planet in the next century--if rapid growth in personal consumption and waste can be contained." Jesse, Ausubel H. "Can Technology Spare the Earth?", in American Scientist, March-April 1996, Volume 84, No. 2. http://www.amsci.org/amsci/Articles/96Articles/Ausubel.html

1.1 The Burden of Taxes on Real Estate

The ownership of real estate, the various uses of property, and the profit resulting from the sale of real property was utilized in history as a "good excuse" to draw taxes by a ruler on his subjects.

In ancient Egypt, a tax of 20% was imposed on the crops.[6] In ancient Greece in the 5th century BC a tax was imposed on selling of real estate.[7] As the burden of different types of taxes grew, the efforts of the taxpayer and his consultants looking for tax shelters increased.

In 1918, Joseph Schumpeter[8] observed, "The fiscal history of a people is above all an essential part of its general history. An enormous influence on the fate of nations emanates from the economic bleeding which the needs of the states necessitates, and from the use to which its results are put... The spirit of a people, its cultural level, its social structure... all this and more is written in its fiscal history, stripped of all phrases. He who knows how to listen to its message here discerns the thunder of world history more clearly than anyone else."

Other scholars have argued that the burden and harm of taxation have been even worse than war and conquest. English classical economist Nassau Senior[9] stated in the 1840s, "Arbitrary taxation, in despotism to supply the wants of the ruler, in aristocracies and in oligarchies to supply the state, is perhaps still more destructive to providence than even war. The presence of the foreign enemy is occasional and local, that of the tax-gatherer is universal and perpetual. The one can be resisted, the other can be only eluded."

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6 Genesis, chap. 47, par. 24. "And it shall come to pass at harvest times, that you shall give the fifth part to Pharaoh, and four parts shall be your own, for seed of the field, and for your food, and for them of your households, and for food for your little ones."

The word *Fiefdom* in English is derived from this Biblical example of 20% (one - *fifth*) of a serf's land production being a compulsory payment to the landlord or king.

7 Fuks, Alexander. The Athenian Commonwealth, Politics Society Culture, Hebrew edition, Mosad Bialik, Jerusalem 1964, p. 77.

8 Joseph Alois Schumpeter, Feb. 8, 1883 - Jan. 8, 1950, a Moravian-born American economist and sociologist known for his theories of capitalist development and business cycles.

9 Nassau Senior, September 26, 1790 - June 4, 1864, was a British classical economist who influenced the political and economic policies of his days.

It has also been insisted that by taxing the wealth and property of those who are the producers of any society the state merely succeeds in creating a class of non-producers who live off what others have produced and bringing into existence a category of wasteful expenditures for the goods these non-producers consume.

"I conclude," said American economist Thomas Cooper[10] in 1830, "that taxation increases the number of unproductive consumers, and the amount of unproductive consumption; and tends, not to enrich, but to impoverish a nation. Hence, as taxes are an evil, the fewer we have of them, and the smaller the amount, the better."

The distinction between those who pay taxes out of their productive efforts and those who consume the wealth of those others was never made more clearly than by the 19th century American statesman John C. Calhoun.[11] Calhoun explained that "the unequal fiscal action of the government... divides the community into two great classes: one consisting of those who, in reality, pay the taxes and, of course, bear exclusively the burden of supporting the government; and the other, of those who are the recipients of their proceeds through disbursements, and who are, in fact, supported by the government; or, in fewer words, to divide it into taxpayers and tax-consumers."

The modern economy since the industrial revolution and the need for sophisticated systems of selling goods developed the theory of marketing. This theory deals with the analysis of -

a. The needs, wants and demands of consumers;
b. The choice of products - goods, services and ideas;
c. The understanding of the subjective value that a specific product or service has in the eyes of a specific consumer;
d. The price of the product and the satisfaction gained by the consumer;
e. The buying patterns of the product - selling and barter methods;

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10 Thomas Cooper, March 20, 1805 - July 15, 1892, an English writer whose political epic the purgatory of suicide promulgated in verse the principles of Charism, Britain's first specifically working-class national movement, for which Cooper worked and suffered imprisonment.

11 John C. Calhoun, March 18, 1782 - March 31, 1850, an American political leader who was a congressman, secretary of war, seventh vice president (1825–32), senator, and secretary of state. He championed states' rights and slavery and was a symbol of the Old South.

f. The development of long term relationships with suppliers, marketers, point-of-sale and consumers; and
g. The study of different market factors, the forecast of market trends, and the preparation of the marketing foundation according to these trends.[12]

Because this dissertation focuses on the marketing of real estate, I found it appropriate to apply the general marketing definitions to the special nature of this "product".

The rise and fall of civilizations is caused by the kinds of taxes levied and the means used to collect them. Rome fell because the egalitarian tax reforms of Emperor Julian were weakened and finally overturned by his greedy, arbitrary successors.

The Moslem hordes of the Middle Ages are seen as mild-mannered revenue agents, which explains why Islam spread so widely before the world's first excise tax unhinged its empire.

Enlightenment thinkers equated liberty with tax consent and defined tax freedom as a "natural right": The American Revolution codified that strain of thought.

"Will we end up as citizen-serf-taxpayers like the later Romans? The current direction of our tax system's penal laws and spying devices makes this a possibility. We can find ourselves shackled to a kind of neo-serfdom to the modern fiscus. If that happens, then the struggle between democracies and dictatorships will enter a new phase in which the choice will be not liberty or bondage but, rather, which kind of bureaucratic bondage." [13]

Even when governments have instituted tax regimes that did not originally completely suppress all incentives for work, saving and investment, the fact is that the systems have always degenerated into exactly that - engines for economic stagnation and decay. The only times when governments have, in general, pulled back and lightened the burden and the pervasiveness of its tax regimes were when they were under threat or actualized revolts of the taxpayers.

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12 See definition of "marketing" in paragraph 2.1

13 Adams, Charles; Rabushka, Alvin. For Good and Evil: The Impact of Taxes on the Course of Civilization. New York: Madison Books, 1993.

Even in these situations, often the lifting of the tax burdens and the moderating of the methods of enforcement have been more an illusion than reality. From the beginning of recorded history, governments have used the same methods of enforcement that dominates our own time: spying, audits of tax records, imprisonment and confiscation of property for failure of proper payment, lies, and deceptions.

Since the 18th century, when governments have become increasingly democratic and supposedly a reflection of the will of the people, those governments have continued to impose increasingly higher taxes. The key to understanding this phenomenon is the myth of democratic government. Since under democracy, the people are supposed to rule themselves through the representatives they elect, there is the belief that government can never be oppressive, because the people cannot oppress themselves. But "the people" never rule, even in a democracy. It is always a coalition of groups who elect those who hold office, and a primary purpose of forming such coalitions is to obtain financial support from the state for various purposes at the expense of others in the society who are made to pay for them. Our leaders claim that big governments and big spending ought to solve the world's problems.

1.2 Methodology

The first phase of this research was the investigation of three different fields: marketing, land, and taxation.

Marketing is a modern science, that developed mainly in the 20^{th} century. The need for marketing attitude evolved after the world faced a new phenomenon in the human history - over productivity. Before the industrial revolution the main market was an agriculture domestic market where peasants or merchants sold mainly food and craftsman offered their skills. There existed an unsophisticated competition but merely a need for strategic marketing methods.

Land is a most powerful factor in human life. It is driven by instincts to have a territory and to guard it. During the history land and territory were the main reason for wars. The use of land has two main categories - private ownership, and feudal regime (especially in rural land) where a vast country belongs to few families and peasants who are practically slaves.

Taxation is an ancient phenomenon with modern trends. The modern democratic regimes impose taxes preaching similar excuses to their subjects as counts and dukes preached to their vassals and the chief preached to his fellow caveman, "it is necessary for the community and I have the power to collect it".

The second phase of this dissertation is to merge these three different fields into untraditional strategies of marketing of real estate.

The trend of a growing population leaves less land per person. Since the industrial revolution people move from the country to the growing cities. I discuss these trends through the history of man and land.

1.2.1 Statement of the Issue

Marketing of real estate has its traditional methods - advertising, adjusting market price, finding segment markets etc. While doing so, the competitive market uses the same traditional techniques.

1.2.2 Purpose of the Research

This research is designed to provide entrepreneurs and contractors untraditional methods to improve their prospects of marketing in the competitive market.

1.2.3 Basic Premises of the Research

The Competitive Bidding Pack - Imagine a pack of wolves hunting for prey. The pack may run very close together or spread out over a significant distance. As they hunt, the leader of the pack changes frequently. Sometimes, being the leader has its advantages. If the pack encounters a small rabbit, the leader will be able to catch the rabbit for itself, regardless of the distribution of the pack. However, if they encounter a bear while spread out, the leader is probably going to die before help arrives. Obviously, the optimum position for any one wolf is to be the first in line for lunch without running so far ahead of the rest of the pack. The leaders of the pack will be the aggressive wolves, who are hungry and willing to take the risk of leading. Other wolves may tend to be apathetic about hunting and disinterested in leading the pack.

A group of entrepreneurs and contractors, who bid competitively for marketing their real estate, can be similar to the pack of wolves. They are hunting for the customer in a hostile environment. Like the lead wolf, the lead entrepreneur or contractor needs to optimize his position, offering lower prices to sell his building but not offering much lower than his closest competitor. To find the optimum position, the contractor must take into account how hungry/aggressive, or how satiated/disinterested, the other entrepreneurs or contractors are.

The Pack Price - The usual approach for marketing in a competitive market is the concept of the "pack price". The pack price is defined as the lower of the two bids that are closest together. The pack price is the price upon which two, independent, equally informed, competitive entrepreneurs or contractors came closest to selling their building.

The pack price marks the division point between the aggressive contractors, who will bid lower than the pack price, and the disinterested contractors, who will tend to bid more than the pack price. The pack price can be defined as the break point between the aggressive bidders and the disinterested bidders. Thus, the pack price should reveal what the price of the building would be if there were no aggressive bidders desperately trying to beat everyone else and if there were not disinterested bidders purposely bidding high.

The Emotional Approach - The backbone of this research is the concept of the emotional approach of the customer of real estate. The emotional approach to buying and owning real estate assets will be presented in this research.

One may expect that his competitors will not use the untraditional methods he uses. The hypothesis of this research is that using those methods will submit a unique advantage in the competitive market.

This research does not intend to underestimate the traditional methods of real estate marketing, it merely presents untraditional methods to handle this issue.

Taxation and Real Estate - In order to understand the significance of taxes in real estate buying, selling and owning process, I describe the essence of taxes and the various compulsory payments imposed on land and buildings in the history and nowadays. The target customers (market) are those who prefer to buy real estate and enjoy the benefit of tax shelters and anonymity. The target product should be adjusted to this target market.

The purchase of real estate, when the profit from the sale is tax-free is known to only a small stratum of sophisticated investors, assisted by lawyers and consultants specializing in this area. This know-how is not accessible to the majority of the population who is used to investing in real estate and paying taxes on their profit at the time of sale.

The marketing of real estate through the incentive of tax shelters is aimed at this large stratum of the population. There is an inherited resistance to pay taxes to the rulers - kings or democratic governments, without breaching the law.

The **first premise** is that the consumer, who wants to buy real estate assets, will prefer to do so in a way that allows him to enjoy capital gains without sharing it with the Treasury and to enjoy various economic benefits.

The ownership of real estate is registered in the land registry bureau. The registry is open to the public and the procedure of the registration process is rigid. The **second premise** is that this common method does not have the benefits of selling shares in a "real estate association".[14]

1.2.4 Benefits of the Research

The main benefit of the successful completion of this research is to enable entrepreneurs and contractors to better understand the mental state of mind of the customer of real estate. As a result, the entrepreneur may be able to require a unique advantage in marketing real estate based on a new understanding of the impact of emotional reasons involved in the process of buying a residence for dwelling, offices, shops or any other asset. This would give him one more piece of information to use to improve his marketing strategies.

He may find that his probability of marketing similar real estate assets at the same

[14] See definition of "real estate association" in paragraph 6.1

price as his competitors is much higher by offering his customers tax shelters and/or anonymity.

1.2.5 Summary

This dissertation discusses two marketing methods for real property via two tax shelters anonymity and economic benefits: the sale of shares in a real estate association, and barter-transaction in real property. The goal is to enable unconventional methods of marketing.

The possibility of enjoying a tax-free profit and economic benefits on one hand, and the anonymity of ownership over real estate as well as simplicity of the registration process of ownership on the other hand, are presented as the main incentives for the potential buyer.

1.3 Epistemology

The real estate market is a traditional one, and most of the transactions are performed in the same legal way as hundreds of years ago. Upon this traditional transactions the legislators imposed traditional taxes that are almost impossible to reduce or avoid.

The traditional method of land registration reveals the identity of the owner. When somebody prefers to stay anonymous, he might register an association, i.e. offshore company, and buy property via this association.

The issue of untraditional methods of real estate marketing fascinated me for many years. Since I could not find books or references dealing with these methods, I found it important to try to clarify its advantages as I see it.

The starting point is to dismantle between buying, selling and owning real property and the legal and personal outcomes lays in abandoning the traditional methods of dealing and owning.

The method to dismantle the traditional linkage between selling and buying real property and taxes imposed on it lies in the untraditional methods of performing sales as it was described above. Marketing of real property via pre-registered real estate association (REA) may create various tax shelters as well as anonymity.

Using these methods creates an edge in marketing real property by offering tax shelter and anonymity as well as other economic and personal advantages to both parties - sellers and buyers. This unconventional marketing does not need to compete with others performing the traditional deals in the various real estate markets.

Chapter 2 Marketing

2.1 Definition and Terms

"Marketing" is a social and managerial process by which individuals and groups obtain what they need and want through creating, offering, and exchanging products of value with others.[15]

This definition is one of many, and it is a difficult term to define in a business sense because the word is used in so many ways.[16]

The philosophy that marketing strategies must be based on known consumer needs has come to be known as the marketing concept.[17]

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[15] Kotler, Philip. Marketing Management, Analysis, Planing, Implementation, and Control, 9th edition, p. 9.

[16] "Marketing" is a series of planning and management activities leading to transaction between a seller and a buyer - a process that makes it possible to sell goods or services to people who want to buy them. Keegan, W. & Moriarty, S. & Duncan, T. Marketing, 1992, p. 6.

[17] This view, which began to win wide acceptance in the mid-1950s, seems so logical today that one wonders why marketers did not turn to it sooner. There are two reasons. First, marketing institutions were not sufficiently developed before 1950 to accept the marketing concept. Products were distributed and advertised on a mass-market basis; few were targeted to defined consumer segments according to their needs. The marketing concept requires a diversity of facilities for promoting and distributing products to smaller and more fragmented market segments. This diversity in marketing institutions did not exist before 1950, when the emphasis was on economics of scale in production and marketing.

2.1.1 Definition of Marketing of Real Estate

For the purpose of this dissertation, the classic definition of marketing should be altered in order to adjust it to the nature of real estate, and it would be defined as follows.

"Marketing of Real Estate" is a social and managerial process by which individuals and groups obtain what they need and want through offering and exchanging land and creating, offering and exchanging buildings directly and indirectly to others.

In order to understand and analyze this definition, as well as the concept of this dissertation the various terms will be defined in this chapter. Those terms are: *real estate market; market; needs, wants and demands; price; cost; satisfaction; value of real estate; market value of real estate; real estate appraisal;* and *sale and exchange.* One term will be defined in chapter 3: *real estate and real property.* Four terms will be defined in chapter 4: *profit; wages; interest;* and *rent.* Two terms will be defined in chapter 5: *tax,* and *tax shelters*. One term will be defined in chapter 6: *real estate association.* One term will be defined in chapter 7: *direct and indirect exchange.* In light of the specific focus of this dissertation - "marketing of real estate", other terms of the marketing theory will not be considered relevant.

2.2 The Real Estate Market

"Market" - A market is a place where man takes part in the barter and exchange of merchandise. At the beginning of human history, the market was always situated in the middle of a community, on a central street or square, where the producers of food, clothes, and other consumer goods would gather to sell their

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The second reason the marketing concept was not widely accepted until the 1950s is that before that time there was no economic necessity to do so. There was little purchasing power during the Depression to spar an interest in identifying customer needs. During World War II and immediately thereafter, scarcities where prevalent. There was no competitive pressure to adjust product offerings to customer needs. Manufacturers sold what they made. They did not have to worry about making only what they could sell. Assael, Henry. Marketing management, Strategy and Action, 1985, p. 9.

wares.[18] The term "market" originally meant a physical place where an exchange occurs - a fair, farmer's market, or bazaar, where people came together to sell and buy things.[19]

The desire to widen the borders of the local market was the main factor responsible for the development of the shipping industry and the search for new markets. Those markets enabled the purchase of goods that did not exist in the native country and the sale of goods that were in abundance. The development of railroad tracks and airports made a worldwide marketplace, existing in conjunction with the local markets. Modern communication such as the press, radio and television allow anybody and everybody to offer easily his goods and services to consumers the world over.

The Internet[20] is the largest marketing tool and it expends rapidly. This tool will be definitely the most important one in the next century.[21]

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18 "Market": A public place in a city or town, where provisions or cattle are exposed to sale; an appointed place for selling and buying at private sale, a distinguished from an auction. Webster's 1828 Dictionary, http://65.66.134.201/cgi-bin/webster/webster.exe?search_for_d:/inetpub/wwwroot/cgi-bin/webster/web1828=market

"Market": an open area, building, or event at which people gather to buy and sell goods or food. A marketplace is a place, usually in an open area, where goods or food is sold. Cambridge Dictionary Online, http://dictionary.cambridge.org/

A Market consists of all the potential customers sharing a particular need or wants who might be willing and able to engage in exchange to satisfy that need or want. Kotler, Philip. Marketing Management, Analysis, Planing, Implementation, and Control, 9th edition, p. 13.

A set of arrangement in which buyers and sellers are brought together through the price mechanism. The Appraisal of Real Estate, Appraisal Institute, 11th edition, p. 19.

19 Keegan, W, Moriarty, S, Duncan, T, Marketing, 1992, p. 7.

20 The World Wide Web is the latest stage in the hyper-accelerated evolution of the Internet and is responsible for its current popularity. The rapid rise to prominence of the Internet over the last few years, especially the World Wide Web, has left many with the idea that this is an invention of the 1990s. The Internet, however, celebrated its 26th anniversary in 1995. The Internet is ideal for real estate marketing in that it allows consumers to search worldwide for property listings. Power, Glan P., "The Internet: an essential tool", in Canadian Appraiser, Vol.: 40 Iss: 2 Summer 1996, pp: 43-46.

21 The World Wide Web is an on-line information service on the Internet. Since early 1995, the number of people with access to the web has grown from about 2 million to somewhere around

Market includes all potential consumers who need and want a certain product and are willing and able to give something of equal value in return. The term "market" relates also to a group of consumers who are interested in a specific product; i.e. the food market, the confection market, the sport car market, the youth market, the North American market, the employment market, etc.

The real estate market[22] also answers this general definition and it can be found in the real estate sections in the newspaper, radio and television. Today, it is also possible to find tens of thousands of web sites on the Internet that offer the entire scope of real estate assets all around the world.[23] There is land for building, offices and shops for purchase or rental, luxury apartments and less expensive ones. There are even sites where tenants seek partners to share the rent.

2.3 Needs, Wants, and Demands

At the forefront of marketing theory is the principle that man needs wants and demands certain products. Concerning the marketing of real estate, man *needs* a place to live and, sometimes, to work from. He *wants* a place, where he can entertain and rest, and *demands* real estate in a specific place, in the building style and size that he likes.

People have a "need" for a dwelling, and a real estate asset from which they can make a living. That need is an essential need, and is not a need created by a

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20 million. Martin, J Roger, "Marketing on the World Wide Web", in Commercial Investment Real Estate Journal [CIJ], Vol: 14, Iss: 5, Nov/Dec 1995, pp: 30-34.

22 "Real Estate Market": The potential buyers and sellers of real estate at the current time, and the current transaction activity for real estate. It includes markets for various property types, such as housing market, office market, condominium market, and land market.

23 Today's commercial real estate professionals have ample marketing options to get their names out. In addition to such methods as advertising and promotional efforts, direct mail, and destinations, brokers, can take steps that include networking at organization meetings, picking up leads from residential brokers, and taking their marketing endeavors international. With the advent of Internet marketing, conventional forms of advertising may diminish in importance. Today, visibility need not be limited to local or even national markets. Increasingly, newsletters have become an important direct mail tool for both large and small firms. McCloud, John, "Taking Marketing to the Next Level", in Commercial Investment Real Estate Journal [CIJ], Vol: 17, Iss:2, Mar/Apr 1998, pp: 42-44.

specific society or by marketing. The *desire* to be the owner of a vacation home is designed according to the culture and tradition of the society.

A "demand" is the relationship between price and quantity demanded for particular goods and services in particular circumstances. For each price the demand relationship tells the quantity the buyers want to buy at that corresponding price. The quantity the buyers want to buy at a particular price is called the "quantity demanded". The demand for a specific architectural design of a building, and the place and size of the asset, are the direct results of the person's financial capabilities and his desire to purchase.

Buyers are the people who want or need the product or service. The term "demand" refers to the willingness and ability of people to purchase the good or service in the market. The demand relationship expresses that willingness and ability for the whole range of prices. To say that a person has a demand for a particular product is to say that the person has money with which to buy and is willing to exchange the money for the goods. People will not demand what they do not want or need, but a want or a need unbacked by purchasing power is not a demand.

Similarly, it is not enough that the suppliers possess the good or the service. Supply also means willingness to sell. Most of us have experience living in the market economic system, and that makes economics seem like a common-sense field -- but sometimes that common-sense feel can be deceptive. People sometimes use the term "demand" ambiguously -- as if "demand" were the same thing as need. But it is not.

Need without purchasing power will not create effective demand in the marketplace. Economists sometimes stress this point by using the term "effective demand" in place of simple "demand."

Demand can be ambiguous in another way. We should not think of "demand" as a particular quantity -- because the quantity that people are willing and able to purchase will change when the price changes. Economics assumes that there is a systematic relationship between the price in the marketplace and the quantity that people are willing and able to buy. This relationship is called "the demand relationship" or, simply "demand." The quantity that people buy at each price is called the "quantity demanded" at that price. We think of the "demand relationship" as a relationship between the price and the quantity demanded.

It is important to distinguish between the demand relationship and the quantity demanded. This may seem like "splitting hairs," but not making the distinction between them causes a lot of confusion. The convention in economics is to use the word "demand" to mean the demand relationship and "quantity demanded" for the specific quantity that people are willing to purchase, when there could be confusion.

The law of demand is that at a higher price, the quantity demanded will be less, and it creates the "ceteris paribus".[24]

2.3.1 Price and Cost

There is a difference among the price of a specific real estate asset, its cost, its market value, and its worth or value, as far as the purchaser and seller are concerned.

"Price" - The price is the amount paid by the buyer to the seller for a specific asset. When Solomon pays Abraham the agreed price of $100,000 for his apartment, this price is a fact regardless of the market value or the value, which each party might put on it.

A price, once finalized, represents the amount a particular purchaser agrees to pay and a particular seller agrees to accept under the circumstances surrounding their transaction.[25]

"Cost" - The term cost is used in relation to production, i.e. the cost of a building is the price paid to purchase the plot, to the architects who prepare the plans, to the contractor who built the building etc. The act of predicting the total costs of labour, materials, capital, and professional fees required to construct a proposed project is known as "cost estimating in construction".

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24 "Ceteris paribus" is a Latin phrase often used by economists, literally meaning "other things equal." Used in the context of an economic model, it means all the variables that might affect the equilibrium in the model are held constant unless we explicitly say otherwise.

25 The Appraisal of Real Estate, Appraisal Institute, 11th edition, p. 19.

2.3.2 Cost and Satisfaction

Variable costs are costs that can be varied flexibly as conditions change. Labour costs are the variable costs. Fixed costs are the costs of the investment goods used by the firm, on the idea that these reflect a long-term commitment that can be recovered only by wearing them out in the production of goods and services for sale.

The idea here is that labour is a much more flexible resource than capital investment. People can change from one task to another flexibly, whether within the same firm or in a new job at another firm, while machinery tends to be designed for a very specific use. If it isn't used for that purpose, it can't produce anything at all. Thus, capital investment is much more of a commitment than hiring is.

In the 18th century this was clearly true. Over the past century, education and experience have become more important for labour, and have made labour more specialized, and increasing automatic control has made some machinery more flexible. So the differences between capital and labour are less than they once were, but all the same, it seems labour is still relatively more flexible than capital. It is this relative difference in flexibility that is expressed by the simplified distinction of long and short run. Of course, productivity and costs are inversely related, so the variable costs will change as the productivity of labour changes.

How does the consumer choose a real-estate product that answers his needs? When Joji has a job in a specific town, he probably purchases a dwelling place in the same vicinity, in the same city or in a nearby community, on the condition that he is assured accessible and inexpensive transportation to his place of work. These alternatives describe the factors considered by a person who is choosing the location of his home.

Suppose that Joji buys an apartment in a building that was built in the 19th century, in a skyscraper, in a building with a modern design, or in a neighborhood with young where there are community services for his children. These factors illustrate his decision based on satisfaction of his wants.

The guiding principle at the beginning of Joji's choice is the level of *value* and *satisfaction* achieved. *Value* is a subjective term that describes how Joji estimates that a specific apartment will answer all of his needs, wants and demands. If Joji wants to live near his place of work, then he must purchase a home in the center of town, and pay a large sum of money for this. In this case, Joji must give up on the purchase of other products and services that he needs and is interested in. By purchasing a less expensive apartment in a place farther from town, Joji can make available his resources to purchase other products and services. During the decision process Joji can best use the money available to him. *Satisfaction* is the supply of Joji's need to buy an apartment at the lowest possible cost.

Usually we measure the cost and the value at present time, especially if we intend to buy a product or an asset. In some occasions we purchase assets because we believe that it's price will increase in the future i.e. stamps or gold. This belief gives us the incentive to obtain it and it creates a value.

In other occasions we buy property because the profit is tax free, and that is considered as a value. Sometimes the desire to stay anonymous creates for us value, and drives us to purchase an asset that does not reveal the owner's identity. A convenient cash flow can make the whole difference for many buyers especially when we deal with purchasing plots that are considerable expensive.

2.3.3 The Theory of Supply and Demand

The theory of supply and demand is a theory of price and output in competitive markets.[26]

Adam Smith argued that each good or service has a "natural price." If the price (of beer, for example), were above the natural price, then more resources would be attracted into the trade (brewing, for example), and the price would return to its "natural" level. Conversely, if the price began below its "natural" level, then fewer resources would be attracted into the trade, and the price would return to its "natural" level.

The modern theory of supply and demand differs from Smith's theory. Economists have made some progress in the last 200 years, and great economists such as John

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[26] Essential Principles of Economics: A Hypermedia Text from The journal of Economic Education, http://william-king.www.drexel.edu/top/prin/txt/Ecotoc.html

Stuart Mill, Alfred Marshall and many others have played their part in the growth of the modern theory of supply and demand. Nevertheless, the theory of supply and demand is the modern expression of Smith's great insight about "the natural price."

Before about the 1850's most economists accepted the Labour Theory of Value as the theory of the "natural price." But there were some cases it did not apply to: international trade, for example. John Stuart Mill suggested, "supply and demand" solutions for prices in international trade. Other economists extended it to apply to prices in general.

Unlike the "natural price," a long-run theory only, the theory of supply and demand applies in the short run as well as the long.

Competitive markets work through an interaction of "supply and demand." Alfred Marshall compared the supply and demand sides to the two blades of scissors -- one won't cut by itself. You have to have both.

Equilibrium of Supply and Demand - The interaction of supply and demand is understood as *equilibrium*. We may think of demand as a force tending to increase the price of a good, and of supply as a force tending to reduce the price. When the two forces balance one another, the price would neither rise nor fall but would be stable. This analogy leads us to think of the stable or natural price in a particular market as the "equilibrium" price.

This sort of equilibrium exists when the price is just high enough so that the quantity supplied just equals the quantity demanded. If we superimpose the demand curve and the supply curve in the same diagram, we can easily visualize this equilibrium price. It is the price at which the two curves cross. The corresponding quantity is the quantity that would be traded in market equilibrium.

Competition and Equilibrium - The price is in constant motion, up or down, except when quantity demanded is equal to quantity supplied. Put another way, it is the price toward which competition pushes the price. At equilibrium, there is no competition either to buy or to sell, because everyone can buy or sell however much they may wish, "at the going price". But whenever the market is away from equilibrium, competition will arise and tend to force it back. Competition eliminates itself, by forcing the market into equilibrium, in which there is no need to compete.

2.4 Value of Real Estate

Value is extrinsic to the commodity, goods, or services to witch it is ascribed. It is created in the minds of the individuals who constitute the market. Four interdependent economic factors create value: utility, scarcity, desire, and effective purchasing power.[27] A value of real estate is the result of the use that it has for people, nations and governments. Nevertheless, the value of a real estate asset is a subjective concept. There is a difference between the market value of a certain asset and the value of said asset in the eyes of the seller or the buyer.[28]

Sometimes, the seller is interested in the quick disposal of the real estate in question as a result of financial or legal difficulties, in which case he is willing to settle for a lower price than the market value. Abraham knows that the market value of the asset that he would like to sell is $100,000, but he requires cash in order to have surgery that could save his life.[29]

Paul hopes that he will recover from his illness, continue to live or get better and earn money in the future influences the value of the real estate he wishes to sell therefore, he will sell it for less than it is worth. Also, when someone is facing

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27 Utility is the ability of a product to satisfy a human want, need, or desire. Scarcity is the present or anticipated supply of an item relative to the demand for it. Desire is a purchaser wish for an item to satisfy human needs or individual wants beyond the essentials required to support life. Effective purchasing power is the ability of an individual or group to participate in a market. The Appraisal of Real Estate, Appraisal Institute, 11th edition, p. 28.

28 In par. 2.4 I defined *Value,* as a subjective term that describes how Joji estimates that a specific apartment will answer all of his needs, wants and preferences.

29 The sellers of a real estate property and his broker have two primary goals: to sell the property for as high a price as possible and as quickly as possible. While these are separate objects they are closely related through the listing price of the seller. The listing price affects how long it takes to find a buyer (i.e., Time on the Market = TOM) and TOM influences the price that results from the bargaining between the seller and the buyer. This leaves the seller and his agent with an important question: What is the optimal price to be asked for the property? Yavas, Abdullah. & Yang, Shiawee. "The Strategic Role of Listing Price in Marketing Real Estate: Theoty and Evidence", in Real Estate Economics, 23(3), Fall 1995, pp. 347-368.

bankruptcy or the loss of a business due to a cash flow deficit, he will sell his real estate for less than its value because at the same time, the real estate has a lower value than his business or his reputation.

When Joji has a building site upon which he cannot build because of planning restrictions or squatters and other nuisances, he may sell the asset at a lower price than its real value. Usually, one doesn't have the legal means to deal with the problem, the finances to pay the professionals or the emotional strength to invest his time and money in solving the problem.

In all of the above situations it is obvious that the value of the real estate is determined by the personal circumstances and priorities of the seller and not by its market value. In the same way, when a man is emotionally tied to his house, the value of the house increases above the real value, and sometimes he will not agree to sell the house even if the price received is 50% more than the market value.

Just as the seller might render the asset to be of a different value than that which the market determines, so might the buyer. Sometimes the buyer is willing to pay more than the market value for a certain asset since this specific asset meets his needs and he feels that he must have it.

When Nelu is interested in living in the same building his parents live in, he will pay more for the apartment than it is really worth on the market. When Reuven has a successful store which he wants to expand, he will be ready to spend more for the adjoining store than for a similar store which is not close by. When the buyer has knowledge that is not available to the general public, which means that in the future, the value of a certain asset will increase, he will be willing to pay more for the asset than its actual market value.

In these cases, the value of the asset is determined by the buyer's desire to live close to his parents, his desire to increase the size of his business, or by his hope that the value of the asset will shortly increase significantly.

The conclusion is that the value of an asset is a subjective concept for the buyer and seller alike. It is influenced by the market value, but also by personal factors and private, special needs which are not in the public domain and therefore, have no bearing on the market value of the asset.

2.5 Market Value of Real Estate

Market value is inherently a simple concept. It is an objective value created by the collective patterns of the market.[30] The definition of market value, however, is controversial.

"Market Value" - The market value of a specific asset is the sum that one can expect for the sale or rental of this asset. The market value is determined according to the statistics available regarding the sale or rental of *similar assets,* when the sale or rental is exposed to a *competitive market.*[31]

"Similar Asset" relates mainly to the *location* of the asset, its intended *use* and the *size* of the asset. However, the *age* of the asset, the *architectural style* of the asset, the *noise and nuisance* factor in the surroundings of the asset, the exposure of the asset to passersby, and any number of other factors can influence and determine the market value.

"Location" - There is no point in determining the market value of an apartment in Manhattan in order to determine the market value of an apartment in London, or even in another neighborhood with different features in the same city for that matter. An apartment in an exclusive neighborhood might cost twice that of a similar apartment that is located just 500 meters away in an underprivileged neighborhood.

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[30] Customers buy a seller's offering in order to satisfy three kinds of needs, some of which are conscious and some subliminal. The first is the need for the best possible *price*; this is clear-cut. The second set of needs includes such issues as superior performance, solid reliability, board variety, and ease of use. We call these *product needs*. The third set includes needs that are less tangible, such as up-to-date information provided by consultative selling, ready availability provided by strong distribution system, top-notch customer service, and reassurance provided by the image and reputation of the seller. We call these *non-product needs*. Cleland, Alan S. & Bruno, Albert V. The Market Value Process, Bridging Customer and Shareholder Value, 1996, p. 3.

[31] Current definition of market value reflect different schools of thought on five key points:

1. Cash/cash equivalent versus non-cash equivalent;
2. Real property rights versus real estate;
3. Price versus highest price;
4. Most probable price versus highest price;
5. Equilibrium value versus market price.

The Appraisal of Real Estate, Appraisal Institute, 11th edition, p. 20.

"Use" - There is no point in determining the market value of a store on the main street in Bucharest in order to determine the market value of a residential unit in the same building. A 20-m^2 store on a crowded and noisy street might cost twice that of a 100-m^2 apartment within the same building. On the other hand, a 20-m^2 store in a quiet neighborhood might cost 90% less than a 100-m^2 apartment on the same street.

"**Size**" - Knowing the size of a studio apartment with an area of 20-m^2 will not help to determine the market value of a private dwelling (house) of 200-m^2. A modest studio apartment could cost twice as much per 1-m^2 as a luxury residence.

"**Age**" - The value of a new building cannot be determined according to the value of a building that is 100 years old. It might be that the new building would cost more than the old one and it may happen that the vintage is more expensive.

"**Architectural Style**" - One cannot use the price of a building that is built in a rather common style to determine the price of a building which has been planned by a well-known architect.

"Noise and Nuisance"- The price of an apartment that is exposed to noise from the main road or the smells of an industrial factory will not help in determining the price of an apartment in a quiet location surrounded by trees and gardens. The price of a store in a central bus station will be useless in determining the worth of a store in the heart of a residential neighborhood. The noise is a huge disadvantage for a dwelling, but at the same time, may be a great advantage for a store.

In the search for comparable market prices of similar types of assets, there is no identical asset since this does not exist in the realm of real estate. Two apartments of identical size in the same building are not identical assets. It is possible that one apartment is on the second floor and the other on the third floor. If there is no elevator in the building, it is foreseeable that the apartment on the second floor will be more expensive. In a building with an elevator, it is probable that the apartment on the third floor will be more expensive. Even if both of the apartments are on the same floor, they still are not entirely identical, since one faces the north and is colder in the summer and the other faces the south and is warmer in the winter. In these matters, real estate issues differ from moveable goods. There is no difference, for example, in the worth or value of one thousand television sets of the same specific model, produced by the same factory, during the same period of time.

"Competitive Market" - A competitive market is a market in which prices are set through negotiation among many sellers and many buyers, of their *own free will* and having no *special relationship* between them which could influence the price agreed upon by them.

When there is a monopoly that creates a specific product or provides a specific service, it can set a price for the product or service, and then a free market does not exist. For example, Microsoft provides the operating system for almost all the PC's in the world, and therefore they are considered a monopoly that determines the price of operating systems.

In the marketing of plots for construction, the "Israeli Land Administration" could be defined as a monopoly. They determine the price of land for construction because most of the lands in Israel come under their management. They also determine the price of land by taking national and social factors into consideration and according to the regulations dictated by the interests of the government.

When law determines the price of real estate, a competitive market does not exist. For instance, in Israel, there is a law that determines the rate of rent for assets that have protected residents.[32]

"Own Free Will" - When the state or local authority assumes ownership of the asset, this is a forced sale and the seller is not selling of his own free will.

When one sells an asset as a result of a threat on his life or his business - he is not a seller of his own free will.

When one is forced to buy an asset and pay a price that is decided by the seller, then he is not a buyer of his own free will, and when the law dictates the real estate market and its prices, there is no competitive market. This situation can be found in countries where the government dictates the rental prices of apartment

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32 In Israel there exists two ways to rent assets by regular rent which ends on the date written in the contract, or protected rent which ends according to the instructions of the law of rental protection. Law determines the rate of rent for protected renters, and therefore, it is possible to state that a competitive market does not exist in this area.

dwellings. In countries where there is a totalitarian or socialist regime - a competitive market is not usually created, since there is no buyer or seller who is acting on their own free will.

"Special Relationship" - When a person sells an asset to a member of his family, to a partner, or to a person of influence, there exists a special relationship which may influence the price. Presumably, the same person would not sell the same asset at this same price to someone who is not a relative, partner or person of influence.

2.6 The Appraisal of Real Estate

Real estate appraisal is the discipline by which the value of real estate assets is appraised. It is based upon the expert opinion of a professional, in this case a real estate appraiser, and his goal is to reflect the monetary value of the rights to the real property. The function of a real estate appraiser is to gather data from the field from similar assets, to study the general economic data from the area, and to apply the theories of appraisal to these data.

Different scholars define real estate appraisal in several different ways, with no one definition being accepted by all. However, the differences between the definitions are negligible and the term can be defined, in general, as follows:

Real Estate Appraisal - *The optimum price*, which can be expected in exchange for the rights to a real estate asset on a *given date* after *reasonable exposure* in a *competitive market*, where the seller and the buyer act in *full awareness with no undue pressure.*[33]

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[33] "Real Estate Appraisal" - An estimate or opinion of value supported by factual information as of a certain date. Appraisal principles: Economic concepts used to explain the rationale and process of market behavior. Appraisal principles include anticipation, change, competition, substitution, and supply and demand. According to other school: The highest legitimate amount, on any given date, in cash or equal terms at which the rights to a specific asset will be sold, after a reasonable exposure on the competitive market, under all the acceptable conditions of a fair deal, in the interest of personal gain and free of any undue pressure.
"Appraisal" an act or instance of appraising; especially: a valuation of property by the estimate of an authorized person. Merriam-Webster's Collegiate Dictionary, http://www.m-w.com/
Synonyms: estimation, assessment, appreciation, valuation, evaluation.

The market value must be reached under "sterile" and stable market conditions. This factor is crucial where the unique and complicated nature of real estate is concerned. The conclusion is that "market value" is a result of objective statistics, based on the gathering of data from similar properties and on the conclusions of the researcher or the real estate appraiser who will apply the theory of appraisal to the data he has accumulated.

There is a similarity between the definition of "real estate appraisal" and "market value" mentioned above. It should be mentioned that in the process of appraising real estate, the market value is only one of the factors, albeit the most important one.

2.6.1 The Definition of the Appraisal of Real Estate

One may say that these definitions describe "value of real property" not appraisal. I would prefer the definition: "Appraisal is defined as the act or process of estimating value".[34] Nevertheless, in appraising the value of an asset, an opinion is needed based on the five conditions that appear in the definition of real estate appraisal -

a. The optimum price;
b. On a given date;
c. After reasonable exposure;
d. In a competitive market;
e. Where the seller and the buyer act in full awareness with no undue pressure.

A. "Optimum Price" - The concept of "optimum price" is based on the most probable selling price, which is a theoretical average price based on the data of previous deals. This attitude reflects the "The Sales Comparison Approach" and it uses statistic tools to figure the optimum price. Beside the sales comparison approach there is "The Cost Approach" that figures the cost of the plot, planning and legal fees, compulsory duties, cost of constructing, cost of financing etc. The third one is "The Income Capitalization Approach" that takes the future view instead of the past as the sales comparison approach.

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34 The Appraisal of Real Estate, 11th edition, Appraisal Institute, p. 11.

An appraiser should take in consideration all three approaches, and if he finds great differences among them, he should try to find the "Equilibrium Value".

B. "A Given Date" - The assessment estimates the value of an asset at a specific date, which is called "the determining date". This value is based upon a comparison with past deals. In the written assessment, the future tense is used - "will be sold", and indeed one of the definitions of value is: "...the present value of the future benefits".[35]

Theoretically, this contradiction is resolved if we apply the classic definition of value, which is "the acceptance of an outcome that matches the market data", because the market data is based on the past, even though the market behavior also takes the future into consideration. I use, "theoretically", because the present market value should be influenced by the expectations of the sellers and buyers for the change in the value of the assets in the near future. However, for the purpose of determining appraisals regarding changes in the prices of assets in the future, much expertise is needed and this is not in the realm of public knowledge that creates the market and fixes the prices of real estate deals.

The result is that there is a significant gap between the appraisal of the real property based on the present market value, and the appraisal of the real estate that estimates the value of the asset for the next five years or more. A person who knows how to estimate expected changes and is willing to invest in real estate based on that same estimate, will buy assets at the market value if he believes that its price will increase in the future. He will sell his real property at the market value if he believes the price will decrease.

C. "Reasonable Exposure" - In the appraisal of real estate it must be taken into consideration that the asset will likely be put up for sale or lease after it has been offered to the market in *accepted methods* for this type of asset within a *reasonable period.* For different methods of exposure there are different prices, and the price of reasonable exposure must be set according to the type of asset which is up for sale or rent, and its price.

"Accepted Methods" - The accepted methods of exposure of an asset for sale

[35] This attitude fits The Income Capitalization Approach.

change according to the environment and type of asset. At times it is acceptable to advertise an apartment for rent on signs hung on the front of the apartment in the neighborhood supermarket or on the bulletin board at the university. It is acceptable to advertise different assets on special bulletins in daily newspapers, or to run an international advertising campaign when selling a unique and expensive piece of real estate.

"Reasonable Period" - Advertisement by acceptable methods must continue for a reasonable period. This period should not be too short to allow the determination of an optimum price. Nor should it be a period long enough to allow a decrease in the rental price or a loss caused by interest paid by the seller resulting from debts or interest, which he should have received in exchange for the selling price. The reasonable period of time for assets offered for rent is between 1-3 months and the reasonable period of time for assets offered for sale is up to 6 months. Regarding assets that are in the construction process, the reasonable period is the entire construction period.

D. "Competitive Market" - A competitive market is a market in which prices are set through negotiation, among many sellers and many buyers, of their own free will, and having no special relationship between them which could influence the price agreed upon by them.[36]

E. "The Seller and the Buyer Act in Full Awareness with no Undue Pressure" - The assessment of real estate is determined by the assumption that the asset will be sold or rented when both sides are fully aware of the physical data, the design data, and all other data which may have legal implications. This assumption is based on the fact that the buyer and the seller receive legal advice, appraisal advice and engineering advice at the highest level. The reality is different, and most real estate deals are sealed because of "intuition" on both sides, advice from family members and other emotional considerations.

The real estate appraiser assumes that the seller will not act under any financial, legal or other pressures, which may cause him to accept a lower price than that which another seller could receive. It is also assumed that the buyer will not act under any pressure that will cause him to pay a higher price that another buyer

[36] See definition of "competitive market" in chapter 2.5.

would pay for the same asset. When a real estate assessor expects that pressure will be created upon a large group of sellers as a result of a financial depression or a flood on the market of this same type of asset, or he expects that pressure will be created as a result of a large demand for a specific type of asset, it is his obligation to include these facts along with the aforementioned economic data.[37]

2.6.2 Foundations of Appraisal

In addition to the basic parameters for appraisal of real estate, there are other parameters that a real estate appraiser must take into consideration if the type of asset, its legal status, or economic and governmental factors deem it necessary.

Man pursuits economic goals. The human action shapes the market, and it is necessary to analyze the factors that influence people's attitudes about value.

Anticipation - Value of the asset is also created by the profits and benefits expected in the future. In this respect it is customary to categorize yield properties such as offices, commercial centers, etc. as one group and carry out the assessment according to future rental rates expected for the economic life of these buildings. The value of this type of asset is a function of its potential rent yield that is influenced mainly by the cost of money; i.e. the interest that could be earned by long term deposits.[38]

Change - is the result of any factor that influences the value of the asset. These changes can be identified as follows:

An economic change - In a period of high inflation, when real estate maintains its "real value" but currency loses its buying power, the value of real estate will increase. In a period of monetary stability, when currency has an advantage over real estate, which is not fluid, the value of real estate may decrease.

A social change - The trend of buying apartments rather than renting can increase the price of the apartments for sale and decrease the rental rates of those for lease.

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[37] See the term "Own Free Will" in chapter 2.5.

[38] The value of owner-occupied residential property is based primarily on the expected future advantages, amenities, and pleasures of ownership and occupancy.

A coup d'etat - A revolution causing a change from an undemocratic government to a democratic government is likely to increase the value of real estate; i.e. after the exit of the USSR from Poland in 1989, a full democracy was established, and since that time the value of real estate in Poland has continually increased. A military coup, which creates a ruling generalissimo out of an "unsatisfied" colonel, will definitely decrease the value of real estate in the short term, because such a change indicates instability and economic insecurity. Even a change from a democratic regime to another, can sometimes cause a change in the value of real estate, i.e. in the case of South Africa, the end of the apartheid regime caused a drastic change in the value of the mansions owned by the white population.

A change in the economic system - A change from a socialist economic system to a capitalist system will likely increase the value of real estate, since this change creates or opens up the free market for the buying and selling of real estate assets, and also opens the market for foreign investments.

Remaining lifetime of a building is also a change that influences its value. The remaining lifetime is the period of time during which the building is expected to fall into irreparable disrepair by natural wear and tear, or be demolished at the owner's request. The change is the actual transformation of the building into just a piece of land. Remaining lifetime for a lessee the date of the end of the lease, at which time the possession of the asset returns to the owner. The change from the viewpoint of the lessor is the termination of the lease.

Supply and Demand - The value of a real estate asset is influenced by supply and demand, although not proportionally. "Supply" means, the quantity of a certain type of asset that is available for sale at a given price. "Demand" is the desire and ability to buy a certain type of asset at a given price. The interactive relationship between this supply and demand is what creates the market. Demand, at a rate exceeding 10% of the supply, for instance, can create a price increase of 20%, and demand that exceeds 25% of the supply, for instance, can create a price increase of almost 100%.

The same principal applies when the supply is greater than the demand, and when this is the case for a long period of time it can cause a reduction in the prices of the assets offered for sale or for rent. For instance, after the change in the apartheid regime in South Africa, mansions were offered for sale for only tens of thousands of dollars, whereas several years earlier the prices were in the millions of dollars. The economic value of these assets did not decrease significantly, however, many members of the white population decided to sell all of their property and leave the country. At the same time, there were no buyers for these mansions, as most of the black population did not have the monetary means to buy or live in these same houses.

Competition - The parameter of competition reflects one of the results of a "free market" and refers to the efforts of two or more potential buyers or those of two or more potential sellers to buy or sell a specific asset or a similar one. Competition among a number of sellers will probably decrease the price of said asset and affect the value of similar assets. Competition among a number of buyers will probably increase the price of said asset and affect the value of similar assets.

Substitution - When a number of similar assets are being for sale, the asset with the lowest price will have the highest demand. This concept stands as the basis for the main method used to appraise assets, which is the comparison method. The assumption is that the reasonable buyer will not pay a higher price for a particular asset than he would pay for another asset with similar characteristics. When a unique asset is on the market for sale, a potential buyer has no substitute asset, and therefore, there is no market value for this sort of asset. In this case the comparison method cannot be implemented and the appraiser should implement other methods.

Opportunity Cost - The cost of the option, which was not chosen. This parameter is closely associated to the principle of substitution. This parameter stands out in particular when checking the influence of the rate of yield, which is required by real estate assets in order to be attractive.

Balance - The value of a real estate asset is created and sustained when different parameters, partially complimentary and partially opposing, are to be found in a balanced situation. This parameter points out that a change in one of the fundamental appraisal factors of an asset does not necessarily produce a change in the value of the asset. For example, a luxury villa built with very high building standards, but in an unattractive residential neighborhood, will not "return" the cost that was invested in its construction.

Contribution - The value of a portion of an asset is judged by its contribution to the overall value of the asset. When evaluating an increase in the value of an asset as a result of the change in building rights; i.e. an increase in the number of apartments allowed on the land, then the value of the building rights of the additional apartments decreases due to the additional crowding and the loss of the use and enjoyment of the yard area around the building.

Surplus Productivity - The net income remaining after construction, capital and entrepreneurial costs. This parameter is the basis of the "subtracted value", approach that is used to estimate the value of a plot of land by subtracting the construction and entrepreneurial costs from the value of a building.

Conformity - The value of the asset is created and maintained when the nature of the asset matches the demands of the market. A swimming pool in a private home with a large yard will "create" the value of a mansion. An underground parking facility will maintain the value of an office building in a neighborhood that will be lacking in ample parking spaces in the coming few years.

Externalities - External economic changes may have either a positive or negative influence on the value of a real estate asset. Because of the unique immovable nature of real estate, its value is influenced by external changes such as shifts in government, war, and peace agreements with former enemies. In a democracy, shifts in government are part and parcel of the system and therefore, the influence will be minor and contingent upon the economic worldview of the elected leader.

A shift from a totalitarian regime to a democracy will almost certainly bring an increase in the prices of real estate. However, if the current parliament is deposed along with the leader it has chosen, or the president is deposed and the government is taken over by army generals, this will almost certainly cause a significant decrease in the prices of real estate.

Tension along the borders with a neighboring country will cause a decrease in the prices of real estate and a drawn out war will cause their total collapse although a peace treaty will bring a renewed increase in the prices. This for example, is how the "Oslo Accords" caused a sharp rise in the prices of land in Israel. After the election of Benjamin Netanyahu, the peace process and the negotiations for the establishment of a Palestinian state came to a halt and a cooling off process began in the real estate market in Israel which of course caused the prices to fall.

2.6.3 The Role of Appraisal of Real Estate

A real estate appraisal has various roles in the modern economy. Someone who wishes to sell a real estate asset, as well as one who intends to purchase a property, may consult an appraiser regarding the price. A board of directors may determine strategic planning for the next decade based upon an appraisal, which evaluates the current value and intends to evaluate the foreseen value of various real estate assets.

The purchase of most real estate is financed by loans. The loaning body is willing to offer its financing based upon the value of the asset that is mortgaged to secure the loan. Both parties are in need of the services of an appraiser in order to establish the basic value of the asset that directly influences the amount of the loan.

When a building is damaged, an appraisal is vital in order to establish the compensation that should be paid by the insurance company or the person who caused the damage.

Real estate taxation is generally based upon its value. Property tax is calculated directly from the market value of the assessed property. Income tax and land appreciation tax are imposed on the profit of the real estate seller, and the market value of the real estate was sold can become a factor in the assessment. Betterment tax (also known as a re-zoning levy) is based upon the increasing market value of the real estate that has been re-zoned.

The tax assessor should base his assessment upon an appraisal, and the tax assessee that wishes to oppose this assessment must rely on a professional opinion of an appraiser. Thus, it should be in the court ruling regarding the assessment. When the services of a real estate appraiser are sought, the purpose of the appraisal must be defined at the outset, as it is possible to determine a different value on the same asset depending on the purposes of the asset.

The analysis of different factors in the appraisal of the value of real estate is contingent upon a number of principles and the significant influence of the value of the real estate must be known before identifying how this will be reflected in the appraisal of a specific asset.

2.7 Sale and Exchange

There are four ways by which a person can obtain products goods and real estate. The first method is self-production. A person can supply his own food by agriculture and shepherding however, it is almost impossible to implement this via the purchase of real estate assets, as almost all land is under private, municipal or government ownership. Although, it is possible to settle land that is located in an isolated area with no owners and maintenance of tens of years could possibly serve to achieve ownership for the maintaining party. It is also possible to purchase land and build on the land independently. In this case, it is possible to refer to the real estate asset as an asset that is partially purchased and partially produced independently. Independent work does not have a market and is not marketable.

Another way to obtain a product is to steal it and this method is nearly impossible to implement in real estate. However, it is possible to forge the ownership registration and to sell the real estate before the forgery is discovered. This is not a popular method since there is much care taken in the management of real estate registration. In addition, an invader on a piece of real estate can be considered as someone who steals real estate. As long as the invasion continues, the invader profits from the economic benefit resulting from the use of the land. If the invasion continues for a period of decades, the invader may receive legal protection from eviction and in that case, the economic value of the real estate increases with regard to said invader. Since these methods are difficult to implement and it is difficult for the offender to hide, there is a limited amount of cases found where real estate is obtained in this way.

The third way to obtain a product is through charity. This method is also not appropriate for the purchase of real estate although sometimes it is possible to live in a home for a limited period of time without paying rent. In this way, a homeless person can live for a limited period of time in a shelter that belongs to a church or charitable organization whose purpose is to assist the lower class population. It may be considered obtaining a real estate asset by charity when a church or other charitable organization inherits a property via the will of a deceased.

The fourth way to obtain a product is through exchange or barter. This method is implemented through obtaining liquid and real estate assets. The price of the real estate may be paid by currency or by exchange of goods, services or other real estate. The exchange of real estate for services associated with said real estate could provide the opportunity for a tax shelter.[39] The need for marketing is created when a person is able to and is interested in giving something in exchange for the real estate.

2.7.1 The Barter

The term "barter" can be used to refer to payment in currency, when the barter of a product or real estate occurs for money. However, for the purpose of this dissertation, there is significance in the differentiation between exchanging real estate for another real estate and selling a part of a plot in return for construction services on the same plot.[40] Therefore, I will limit the term "exchange" to be used to describe a payment in currency. The term "barter" will be used to describe a payment for real estate by exchanging it with another real estate or selling a part of a plot in return for construction on the same plot.

Professor Kotler uses 5 conditions in order to facilitate exchange - and the intention is also for the exchange of products for money.[41]

In reality, barter is the most primitive form of doing business for mankind. The caveman exchanged zebra leather for meat or fruit gathered by his friends. The

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[39] On the difference between exchange and barter see chapter 7.

[40] ibid.

[41] "Exchange" is the act of obtaining a desired product from someone by offering something in return For exchange potential to exist, five conditions must be satisfied:

1. The existence of two or more interested parties.
2. Each party has something that might be of value to the other party.
3. Each party is capable of communication and delivery.
4. Each party is free to accept or reject the exchange offer.
5. Each party believes it is appropriate or desirable to deal with the other party.

Kotler, Philip. Marketing Management, Analysis, Planing, Implementation, and Control, 9th edition, p. 11.

farmer brings the wheat that he gathered to market, and exchanges it for fish that the fisherman brings, or clothes from the seamstress. This way became difficult when the buyer of the donkey wanted to pay with 10 bags of flour and the seller of the donkey only needed two bags of flour and enough lamb for his family's festive dinner and wool for knitting. Both sides of the deal had to find the seller of lamb and the seller of wool who were interested in the leftover 8 bags of flour from the original deal. This type of exchange is called "natural market".

This situation created the need for an "item" which had a constant value and relatively low weight, in order to pay for the remaining goods which had been exchanged. These qualities are present in rare metals and even in salt,[42] which were used for a long period as a means of payment. Three millennia ago the Greeks invented the coin, a precious metal of a standard and recognized weight, upon which was stamped the image of the leader.[43] In this way the "monetary market" was initiated, and seemingly the end of the natural market. Today, the natural market is enjoying a renaissance for the following two reasons -

a. Countries usually put a burden on the import of products from other countries, in barter exchanges with their native products, the reason being to encourage local industry and to sustain reserves of foreign exchange.
b. In a barter deal, product is exchanged for another product or service and many times a monetary value for the products exchanged are not determined. This creates an opportunity for tax shelters.

In order that a deal between two or more sides will succeed, each party must receive the product or real estate he needs, is interested in and prefers, and it must satisfy the needs of each party, which is to provide satisfaction and meet his preferences. The purpose of the marketing theory is to analyze the needs, wants and preferences of each party and to assign a relative or constant value for each of these needs.

I have mentioned before that sometimes we buy property because the profit is tax free, and that is considered as value to us. Sometimes a convenient cash flow can

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42 In Canada the first pioneers used beaver pelts as "currency" for exchange of goods.

43 Kadman, Leo. & Kindler, Arie. Coins in Jewish and Other Nations Throughout the Ages, Dvir, 1963, pp. 5-16.

make the whole difference for many buyers especially when we deal with purchasing plots that are considerably expensive and such a convenient cash flow has a great value. Sometimes the desire to stay anonymous creates for us the major part of the value, and drives us to purchase an asset that does not reveal the owner's identity. This dissertation will show how to take advantage of these sorts of values and use them as the main strategy of marketing methods.

In order to continue the analysis of the theory of real estate specific marketing methods, I will clarify in advance the distinguishing essence of real estate from other products; it's *nature*[44] and special *role*[45] in the life of mankind.

2.7.2 Sales Management

"Sales management" is the planning, organization, direction, recruitment, training, and motivation of the sales-force within a planned marketing strategy. It includes setting sales objectives and evaluating the results obtained by the sales-force. In very large markets, such as the USA, there might be a hierarchy of sales managers and district managers reporting to regional managers, who in turn, report to a national sales manager.[46]

2.8 The Target Customer

Three elements play a role in the marketing process: customers, distributors, and facilitators. In order to find the target customers, one should know who constitutes the market segment, what do the target customer buy, why, how, when, and where he does it.

Knowing who constitutes the market segment is not simply a matter of knowing who uses a product. For instance, in the decision to purchase a house for the family, the son may be the initiator, the daughter may have an influence upon the family, the wife may be the decider, and the husband may be the purchasing agent

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44 See paragraph 3.2

45 See paragraph 3.3

46 Pallister, John; Isa, Alan. Editors, A Dictionary of Business, Oxford University Press, Compiled by Market House Books.

And the whole family is the user.

The son may read in a magazine that they can save money and decrease tax liability by deducting the interest paid for the loan. Although the daughter as an architect may influence the process, she may not be the key decision-maker. The mother, by virtue of her position in the business and in the family, may make the final decision about which house to purchase. The father may have good negotiation skills, and he may be the purchasing agent. Thus, he will go to different real estate brokers in order to buy a similar house at the best possible price.

An individual may handle more than one of these purchasing functions and may even be responsible for all of them. A marketer must recognize that different people have different influences on the purchase decision, and these factors must be taken into account in crafting a marketing strategy.

It is important to know which products target customers tend to purchase and why they do so. For instance a 200 m^2 house in the country is common and popular. Lately some families built a similar house with additional basement for the use of their grown children. By focusing on needs rather than on products, a contractor is able to gain a significant share in the house customers market.

Knowledge of when, where, and how purchases are made is also useful.

A real estate broker, whose target customers tend to rent apartments in August before the beginning of the school season, may send its mailings at the July. A contractor may set up his desk in a businessman convention so that every attendant must pass the desk on his way to the lecture. A real estate agency that knows that customers prefer to finance the perches with mortgage may invite a mortgage bank representative to participate the desk.

Four major types of factors influence consumer-buying behavior: cultural, social, personal, and psychological.

Cultural factors have the broadest influence, because they constitute a stable set of values, perceptions, preferences, and behaviors that have been learned by the consumer throughout life.

Social factors - A consumer may interact with several individuals on a daily basis, and the influence of these people constitutes the social factors that impact the buying process. Social factors include reference groups - the formal or informal social groups against which consumers compare themselves. Typically, the most influential reference group is the family. In this case, family includes the people who raised the consumer as well as the consumer's spouse and children.

Personal factors include individual characteristics that, when taken in aggregate, distinguish the individual from others of the same social group and culture. These include age, life-cycle stage, occupation, economic circumstances, and lifestyle.

Psychological factors are the ways in which human thinking and thought patterns influence buying decisions. Consumers are influenced, for example, by their motivation to fulfill a need, i.e. to buy a house instead renting it in order to fulfill the psychological need for owning own shelter, property and territory.

2.8.1 Market Segments

The aim of marketing is to meet needs profitably. Entrepreneur must therefore define which and whose needs he can satisfy. For example, the house market consists of people who put different values on the house location, size, planning style, cost, and public transportation. No single house can satisfy all these needs in a superior fashion. Because of such variables, the entrepreneur must identify the different preference groups, or segments, of customers and decide which group he can target profitably.

Segments can be divided into even smaller groups, called niches. A niche is defined as a small target group that has special requirements. For example, a mortgage bank may specialize in serving not only house buyers but also house buyers with high income that purchase an expensive house. It is more likely that larger contractors will serve the larger market segments and ignore niches. As a result, smaller contractors typically emerge that are intimately familiar with a particular niche and specialize in serving its needs.

Some contractors may try to serve "segments of one". They attempt to adapt their offer to each individual customer. For example, serving individual customers is possible with the rich and famous movie actors who need a unique house designed by a famous architect in a classic style or with pop singers who need a unique post modern design. Even mass marketing companies, particularly large retailers and catalog houses compile comprehensive data on individual customers and are able to customize their offerings and communications.

If the broker shows the buyer the wrong house because you did not understand the family's true needs and financial status, the buyer may raise objections that are difficult to overcome. Their motivations as buyers should be kept in mind.[47]

2.9 Advertising

Advertising is a paid announcement to persuade or inform members of the public.[48] Outside the theoretical world of perfect competition, advertising of goods and services is necessary to ensure that potential buyers are informed and helps to make markets function efficiently. However, advertising can create or increase barriers to entry into an industry and enhance product differentiation.

Proponents of heavy advertising expenditure argue that it provides a signaling mechanism whereby high-quality producers publicly demonstrate their commitment to their product something they would do only if they genuinely believed that it had a long-term future.

Others point out that consumers may have little choice in a concentrated industry but to bear the cost of unnecessary advertising that serves only to keep out new entrants. Although 'own brand' products in supermarkets (which are not

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47 Shenkel, M. William. Marketing real estate, third edition, Prentice Hall Career & Technology, p. 40.

48 "Advertising" is a communication that is paid for by an identified sponsor with the object of promoting ideas, goods, or services. It is intended to persuade and sometimes to inform. The two basic aspects of advertising are the message and the medium. The media that carry advertising range from the press, television, cinema, radio, and posters to company logos on apparel. Advertising creates awareness of a product, extensive advertising creates confidence in the product, and good advertising creates a desire to buy the product. Advertising is a part of an organization's total marketing communications program i.e. its promotion mix. Pallister, John; Isa, Alan. Editors, A Dictionary of Business, Oxford University Press, Compiled by Market House Books.

advertised) have not replaced advertised brands it could be explained by the power of advertisers to manipulate consumer psychology.[49]

The largest single expense of a real estate office is advertising. The advertising program includes classified ads, which are the least expensive but most effective way to advertise housing, display advertising, billboards, and certain institutional advertisements that build the right image and advance the firm's reputation. Add to this group, radio, television and certain other advertising specialties such as handouts and company-prepared brochures.[50]

2.9.1 Methods of Advertising Real Estate

The conventional methods of advertising real estate for sale or to let are announcements in the printed press, advertisements in radio and television, and special sites in the Internet. Some sellers prefer to use the services of real estate brokers. When we deal with selling many apartments or commercial space, one can apply the "pull strategy" and the "push strategy" besides the conventional methods of advertising real estate.

The pull strategy is a strategy that requires high spending on advertising and consumer promotion to build up consumer demand for a product. If the strategy is successful, consumers will ask their retailers for the product, the retailers will ask the wholesalers, and the wholesalers will ask the producers. This strategy can be applied in real estate marketing by creating a prestigious image to a new neighborhood. Selling few houses or offices to celebrities for a reduced price can create such an image. The next step requires advertising the new neighborhood that is "in".

The push strategy is a strategy that makes use of a company's sales-force and trade promotion activities to create consumer demand for a product. The producer promotes the product to wholesalers, the wholesalers promote it to retailers, and the retailers promote it to consumers. This strategy can be applied in real estate

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49 Bannock, Graham; Baxter, R. E.; Davis, Evan. Editors, The Penguin Dictionary of Economics.

50 Shenkel, M. William. Marketing real estate, third edition, Prentice Hall Career & Technology, p. 116.

marketing by wrapping a common real estate with a middle class fantasy. Selling apartments in a hotel called "time sharing" is a good example. The customer pays $10,000 per one week of "time sharing" for life, and as a matter of fact he buys a small apartment for $520,000 that is worth 25% of that price. That kind of sale takes place in a hotel where the potential customers are asked to spend a weekend as guests of the seller. They find themselves surrounded by a group of salesman, mature gentleman and young stewardess, whose goal is to fulfill the customers' middle class dream.

Another strategy of marketing real estate is the "club whisper". This strategy can be applied in marketing of real estate for members of a union or a club. This kind of advertising is based on cheaper prices for "members only" or for a secret unique "tax shelter". It does not consume a large budget for advertising announcements because it is based on a rumor that is whispered to "best friends".

"There are only 50 apartments to be sold for that unreasonable price", you receive a message from your best friend, "and as you know there are more than a thousand members in our union. The chairman bought already the first apartment, and I bought one yesterday."

2.9.2 The Modern Trend - the Internet

The Internet is quickly becoming the place where customers first look to buy products and services.[51] Amazon, the biggest worldwide bookstore, is a virtual one that exists only six years. The real estate brokerage industry is no exception. Whether relocating across town or across the country, individuals are shopping more and more over the Internet. It is the fastest and least expensive information source available. It is becoming increasingly more important that brokerage firms remain competitive by offering their properties on the Net.

E-commerce is undeniably a significant current and future venue for doing business. With multi-million American adults on the Web it was inevitable that

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51 According to the Q1 2001 ITU Telecommunication Indicators Update from the International Telecommunications Union, there were 214 countries connected to the internet worldwide in 2000 -- a jump from the 60 countries that were connected in 1993. http://www.emarketer.com/estatnews/estats/eglobal/20010420_global_usage_itu.htm

businesses would begin to sell their products and services in this low cost environment. Because of the anonymity of the Web, it is no longer necessary to do business under the traditional framework. Instead, even small firms with a single employee can be represented on the Web the same as a Fortune 500 company.

In the real estate brokerage industry, buyers and sellers are already searching for relocation help through several websites that provide mortgage calculators and information on the quality of school districts, neighborhoods, shopping and parks. In order to succeed in today's e-commerce society, firms must not only anticipate consumer demand, but inform their customers of their products/services through both online and offline channels.

There is a growth in the use of web pages in the real estate brokerage industry. In January 1995, there were approximately 100 real estate websites that offered properties for sale. By the end of 1996, the figure had risen up to approximately 8,000 sites. Some of the sites involved the home pages of single properties while others included listings of over 500,000 properties. While complete marketing and purchasing information was initially lacking in the majority of the sites, this is rapidly becoming the minority of the listings. In 1996, the National Association of Realtors estimated that of the 2 million homes for sale in the United States, only a few thousand were listed on the Web. In 1999, approximately 9% of all web pages on the Internet are associated with real estate.[52]

The results of this electronic revolution are a mixed bag for consumers with greater convenience for potential buyers coupled with a great deal of additional information to examine.

The use of Real Estate Library[53] allows for reference information on home buying and financing including locating a reputable agent. If customers are interested in selling their home, they can see which realtors and news vehicles do the best job at online selling. If customers wish to list privately, they can offer the property on

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52 Michael T. Bond, Michael J. Seiler, Vicky L. Seiler, Ben Blake. Uses of websites of effective real estate marketing, in Journal of Real Estate Portfolio Management, Boston; Apr-Jun 2000, Vol. 6.

53 See the real estate library at http://www.relibrary.com

national selling services such as the owners.com and homebytes.com.[54]

The development of the Internet has caused local real estate brokers to become providers of vast amounts of information. "Full-service" real estate listing services allow prospective buyers to examine their potential new communities. They can learn about shopping, schools, parks, entertainment, transportation, governance, and even crime and police statistics.

The long-run impacts of these and many other changes occurring in real estate brokerage are already being felt.[55] Existing, well-designed real estate websites are generating significant traffic. They allow consumers to shop at their own pace and learn a great deal before they begin any onsite visits. Agents now have a means of promoting themselves and their listings. Moreover, sellers can now easily see other homes in their area and have much more information with which to choose an appropriate broker. For these reasons, it is vitally important for real estate brokerage firms to keep up with the competition by marketing themselves and their properties over the Internet.

2.10 Conclusions

Marketing is a new field in economy, existing merely 100 years. It developed at the end of the 19th century as a result of the industrial revolution that brought the over productivity phenomenon in the human history.

Although, marketing is a new field it has significantly changed within such a short period of time. One may say that the marketing abstract thinking has to be the most flexible one in the economic science in order to adjust to the rapid changes in true life. As a result of those rapid changes marketing scholars should be aware of the new marketing methods all over the globe and in the various sorts of markets in order to describe those developments in lectures, essays and books.

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[54] see http://www.owners.com, and http://www.homebytes.com/index.cfm?flashtype=flashed

[55] The National Association of Realtors http://www.realtor.com releases a free virtual magazine - The Voice of Real Estate at http://nar.REALTOR.com/home.htm that contain articles and resources about real estate in United States.

Chapter 3 Land and Buildings (Real Estate)

3.1 Introduction

"In the beginning God created the heaven and the earth... And God said, Let the waters under the heaven be gathered together to one place, and let the dry land appear: and it was so. And God called the dry land Earth; and the gathering together of the waters he called seas:"[56]

In Genesis, God called the dry land "Earth". Man called earth "land". Land accounts for approximately 30% of the area of the globe, and approximately 70% are oceans and seas. The term *real estate* or *fixed assets* include land and everything that is attached to it permanently, such as buildings, installations and trees. This distinction between "land" and "real estate" is needed for the legal objectives of transaction and registration and of real estate tax laws.

Man refers to land, and anything that is attached permanently to it, "fixed assets" in order to distinguish them from liquid assets such as consumables, goods, metals, precious stones, money, etc. This distinction illustrates the essence of fixed assets, which is immovability. The special value that fixed assets can be understood from the moniker Real Estate, while other assets are simply called "assets". When man evolved from hunter/gatherer to farmer, he tied his fate to territory upon which he built his home and grew his food. Therefore, the land became his dearest and most

[56] Genesis, chapter 1, par. 1, 9, 10.

important asset.

"Land holds a unique place in the distributional ethic because it is (by definition) of natural origin. Man did not create Earth with its resources but rather fights over it. Land is also (with exceptions) more nearly permanent than man or his works."[57]

Charles Darwin[58] wrote: "But we often take I think, an erroneous view of the probability of closely allied species invading each other's territory when put into free intercommunication."

3.2 The Nature of Land

Since the beginning of the industrial revolution, we live in an industrial world that is capable of creating consumables and agricultural products in a supply that meets the demand. However, one product is *almost* incapable of being produced, and therefore does not come under the definition "product", and that is land. I mentioned "almost", because it is possible to turn a sea, a lake or a river into land, and it is possible to turn land into waters. However, the technological difficulties and the high cost of "creating" land limit its size significantly. The result is that the quantity of land in the world is a finite amount, and it is necessary to treat this resource with a special value.

The constant growth of the world's population decreases the amount of land available per person. Modern technology and the invention of the elevator have enabled us to build high buildings in the 20th century. In cities with large populations there exist buildings with tens of floors and thousands of sq. meters on land of only one thousand sq. meters. The result is that an apartment of 100 m^2, which is used as a dwelling place for one family, uses many times the land of only

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57 "land tax", Etwell, John (ed). The New Palgrave a Dictionary of Economics, volume 3, pp. 122, the Macmillan Press Limited, London, 1987.

58 Darwin, Charles. On the Origin of Species by Means of Natural Selection or the Preservation of Favoured Races in the Struggle for Life, chapter xii, geographical distribution - continued, p. 333. (First edition, London, 1859), 1997, Electric Book, London, http://www.elecbook.com/origspec.zip

10 m^2.[59]

Throughout history, the area needed for an agricultural farm had on average 30,000-m^2 as this was the amount of land needed to provide for one family. Then came the land reform[60] in various countries and the industrial revolution. People discovered that with the aid of machinery they need only 200 m^2 in order to provide for his family and 100 m^2 for his lodgings.

Nowadays, with the advent of the computer age, the area of land necessary to provide for one's family is approximately 20 m^2, with 10 m^2 of land sufficient for lodging. Modern agriculture assisted by fertilizers, machines, irrigation and artificial strains of fruit and vegetables, enables a family to make its living on a much smaller piece of land than 30,000-m^2.

3.3 The Role of Land for Mankind

Land is the most basic crucial condition on which mankind depends for its existence. Man lives on the land, builds his home, grows produce for his own nutrition, raises livestock for his own use, and builds industry that produces his consumer goods. Land is also used for many types of transportation such as highways, railroad tracks and airports, which enable mankind to travel quickly from place to place.

In addition to the existential needs that these real estate assets fulfil, there are many other varied roles that these assets occupy in the life of man. Land is used for commercial centers where man exchanges goods he has produced for those he needs. Today man exchanges consumer goods for money; i.e. in entertainment places such as hotels, restaurants, theaters, sports centers, beaches, etc., and for religious purposes such as places of worship, holy sites and cemeteries.

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59 i.e. a 1,000 m^2 plot of land with a built up area of 20% per floor (and 80% yard) and 50 floors has a total of 10,000 m^2 of built up area. In this type of building a 100 m^2 of an apartment uses 10 m^2 of land.

60 The term, "land reform", has been subject to different interpretations. Some have defined it narrowly as a means to provide land to the landless, while others have conceived it broadly as a comprehensive program for the transformation of the entire agriculture economy. Tay, Hung-Chao, Land Reform and Politics: A Comparative Analysis, 1974, p. 11.

Real estate assets of different kinds are also used as the most important channel through which man invests his earnings. An average family "invests" its earnings in a residence, which then serves that family as an additional source of economic security. A merchant invests in the purchase of a store, the industrialist in the purchase of a factory, and those with the financial means might purchase an asset for rental purposes. Companies with large resources, pension funds, and religious organizations which receive donations, might purchase land for long-term investments in the hope that they will enjoy an increase in the value of the asset as well as the cash flow which the asset provides.

Man meets his needs and desires in the scope of real estate through "products" which suit his purposes; i.e. an apartment, a store, a factory or a field. The importance of a real estate product is actually the ownership of the immovable asset[61] as well as the services it can provide. We buy an apartment in order to live in it; we buy a store, factory or field in order to make a living.

3.3.1 Real Estate and Real Property

"Real estate" is the physical land and appurtenances affixed to the land, i.e. trees minerals, buildings, and site improvements. Real estate is immobile and tangible. All permanent building attachments (i.e., plumbing, electrical wiring, heating systems cabinets, and elevators) are usually considered part of the real estate. Real estate includes all attachments, both above and below the ground.

"Real property" includes all interests, benefits, and rights inherent in the ownership of physical real estate. Real property is said to include the "bundle of rights" inherent in the ownership of real estate. Ownership rights include the right to use real estate, to sell it, to lease it, to enter it, to give it away, or to choose to exercise all or none of these rights. The bundle of rights may be compared to a pie, in which each slice representing a separate right or interest. It is possible to own all or only some of the rights in real estate. A person who owns all the property rights is said to have *fee simple title*.

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[61] A different view is presented by Prop. Kotler, ibid: "The importance of physical products lies not so much in owning them as in obtaining the services they render. We buy a car because it supplies transportation service". (My underline H.R.) This difference is a result of the "product's" nature, which in this case is Real Estate and not just movable goods.

"Fee Simple Estate" - A fee simple estate implies absolute ownership unencumbered by any other interest or estate. Selling, leasing, or otherwise limiting the bundle of rights in a fee simple estate creates partial interests in real estate. Partial estate includes leased fee and lease holds estates.

"Leased Fee Estate" - A leased fee estate is an ownership interest held by a landlord with the right of use and occupancy conveyed by a lease to others. The rights of the lessor (the leased fee owner) and the lessee (leaseholder) are specified by contract terms contained within the lease.

3.4 The Relationship between Mankind and Land

The human race exists 100,000 years. Most of this time the human race was hunting animals and gathering fruit and vegetables. During this period of time, people did not attach themselves to the land, even though they occasionally used caves for their dwelling.

The human race evolved from hunter/gatherer to farmer only as merely as 6,000 years ago, and it set its first agriculture farms in Sumer.[62] At the settlement in Sumer man tied his fate to territory upon which he built his homes and grew his food.[63]

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62 "The Sumerians moved into Mesopotamia around 4000 BC, perhaps from the vicinity of the Caspian Sea. They found a people archaeologists call Ubaidians, who were living in villages, farming and using canals for irrigation, near where the Tigris and Euphrates rivers emptied into the Persian Gulf -- an area that came to be known as Sumer. And they found in Sumer a people who spoke a Semitic language who had moved in among the Ubaidians. By 3800 BC the Sumerians supplanted the Ubaidians and Semites, and the Sumerians were working toward their civilization. Sumerians cooperated with each other in building better canals for irrigating crops and for transporting crops by boat to village centers. They improved their roads, over which their donkeys trod, some of their donkeys pulling wheeled carts. The Sumerians grew in number, the increase in population the key element in creating what we call civilization -- a word derived from an ancient word for city." Smitha, Frank, E. The Sumerians, http://www.fsmitha.com/h1/ch01.htm. See: Kramer, Samuel, Noah. History Begins at Sumer: Thirty-Nine 'Firsts' in Recorded History; See: Crystal, Ellie. Crystalinks, Sumerian, http://www.crystalinks.com/sumer.html.

63 A different point of view is presented by Keyfitz, Nathan in his essay: The Growing Human Population, Managing Planet Earth: readings from Scientific American magazine, W. H. Freeman and Company, New York, 1990, p. 61. See chapter 1.

The relationship between mankind and land has its legal and social aspects. The meaning of ownership over land and private property in democratic regimes was an important issue for many philosophers.

"The rights of property, as such, have not been venerated by those master minds who have built up economic science; but the authority of the science has been wrongly assumed: by some who have pushed the claims of vested rights to extreme and antisocial uses. It may be well therefore to note that the tendency of careful economic study is to base the rights of private property not on any abstract principle, but on the observation that in the past they have been inseparable from solid progress; and that therefore it is the part of responsible men to proceed cautiously and tentatively in abrogating or modifying even such rights as may seem to be inappropriate to the ideal conditions of social life."[64]

Owning land is a fundamental right to a free man. The absence of such right or even an absence of economical possibility of a vast population can be considered as a direct or indirect slavery.[65]

3.5 Land Reform

"Land reform"[66] may be defined as any kind of changing the legal, political, and

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[64] Marshall, Alfred. Principles of Economics. An introductory volume, 1890, Book One: Preliminary Survey. Universite Paris 1, CHPE Centre d'Histoire de la Pensée Economique, http://panoramix.univ-paris1.fr/CHPE/Textes/Marshall/Principles/

[65] "The lord of the soil could not separate the serf from the land, nor sell him apart from it, and since almost all the land was fief and there was no capital, practically could not sell him at all. The modern bourgeois forces the working-man to sell himself. The serf was the slave of the piece of land on which he was born, the working-man is the slave of his own necessaries of life and of the money with which he has to buy them - both are *slaves of a thing.*" Engels, Frederick. The Condition of the Working Class in England, Single Branches of Industry. Factory-Hands, 1998, p. 278. Electric Book Company, London, (First edition 1845). http://www.elecbook.com/workclas.zip

[66] "The term, *land reform*, has been subject to different interpretations. Some have defined it narrowly as a means to provide land to the landless, while others have conceived it broadly as a comprehensive program for the transformation of the entire agriculture economy." Tay, Hung-Chao, Land Reform and Politics: A Comparative Analysis, University of California Press, 1974, p. 11.

social system of ownership of the real estate in general, or land or housing in particular. [67]

Agrarian reform may transfer the ownership of rural land from the feudal landlords to the peasants and vice versa or from the people to the state. The modern land reforms liberate the peasantry and abolished the peasant economy. "Agrarian reform, which encompasses the transformation of rural administrative institutions, labour use and markets as well, is the modern form of this concept."[68]

"The most common type of reform involves the redistribution of land titles from one individual to another, from individuals to a group or community at large, or from a group to individuals. The land of one landlord may be redistributed to many individuals, as in Egypt, Iran, or Ireland. Or the land of individuals may be reallocated in favor of the community at large by abolishing private ownership, as in Cuba and China. Or, again, public land may be distributed to individuals, as in various parts of Latin America."[69]

We can find the first land reform in ancient Egypt when Joseph exchanged grain with the land of all the Egyptian people, and Pharaoh became the owner of the land and the people. This land reform changed the social structure of ancient Egypt from a "self owned" rural land system into a feudal one.[70]

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67 "The concept of land reform has varied over time according to the range of functions which land itself has performed: as a factor of production, a store of value and wealth, a status symbol, or a source of social and political influence." Land reform, Introduction, Encyclopaedia Britannica, Britannica.com editors, http://www.britannica.com/eb/article?eu=109594

68 "The redistribution of land property titles by the state is a key issue in poor agrarian countries where land is both the main productive asset and the basis of survival and accumulation for the majority of population, and thus land tenure is the foundation of social structure and political power." Etwell, John (ed). The New Palgrave a Dictionary of Economics, "Land reform", volume 3, p. 117, the Macmillan Press Limited, London, 1987.

69 Land reform, Types of reform, Encyclopaedia Britannica, Britannica.com editors, http://www.britannica.com/eb/article?eu=109594&tocid=13983#13983.toc

70 "And Joseph bought all the land of Mizrayim (Egypt) for Pharaoh; for Mizrayim sold every man his field, because the famine prevailed over them: so the land became Pharaoh's." Genesis, chap. 47, par. 20.

The recorded history of reform[71] begins with the Greeks and Romans of the 6th and 2nd centuries BC. Land in ancient Athens was held in perpetuity by the tribe or clan, with individual holdings periodically reallocated according to family size and soil fertility. Population increase, expansion of trade, growth of a money economy, and the opening up of business opportunities eventually made financial transactions in land an economic necessity.

Land itself continued to be not transferable, but the right to use the land could be mortgaged. Thus, peasants could secure loans by surrendering their rights to the product of the land, as "sale with the option of redemption."

Lacking other employment, the debtor continued to cultivate the land as sixth partner, delivering five-sixths of the product to the creditor and retaining the rest for himself. When Solon was elected chief magistrate in 594 BC his reform law, known as the "shaking-off the burdens," cancelled all debts, freed the "sixth partner", and restored land to its constitutional holders. Solon also prohibited the mortgaging of land or of personal freedom on account of debt.

The Roman reform by Tiberius and Gaius came between 133 and 121 BC. The land reform law, or lex agraria, of Tiberius was passed by popular support against serious resistance by the nobility. It applied only to former public land, which had been usurped and concentrated in the hands of large landholders. Land concentration was accompanied by a shift from cultivation to grazing, which reduced employment and increased the poverty of the peasants, producing a crisis. The *lex agraria* specified minimum and maximum individual landholdings, with an allowance for male children of the family. Surplus land would be expropriated and compensation paid for improvements.

When Gaius was elected tribune about a decade later, he revived the reform and went even further. He colonized new land and abolished rent on small-holdings since rent on large holdings had been suspended as compensation for expropriation. Gaius was killed in 121 BC, and within a decade the reform was reversed: private acquisition of public land was legalized, the land commission was dissolved, rent on public land was abolished, all holdings were declared

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[71] History of land reform, Ancient reforms, Encyclopaedia Britannica, Britannica.com editors, http://www.britannica.com/eb/article?eu=109595&tocid=61983#61983.toc

private property, and squatting on public land was prohibited. Even colonization was ended, and colonies established by Gaius were broken up. Another period of land concentration was inaugurated.

The French Revolution[72] brought a new era in the history of land reform. On the eve of the Revolution, French society was polarized, with the nobility and clergy on one side and the rising business class on the other. The middle class was relatively small, especially in the rural areas. The majority of the peasants were hereditary tenants, either *censiers,* who paid a fixed money rent, or *mainmortables,* or serfs, who paid rent in the form of labour services of about three days a week. The peasants paid various other feudal dues and taxes, from which the nobility and clergy were exempted. The Revolution overthrew the ancient regime and the feudal order and introduced land reform.

The reform cancelled the law of feudal tenures, freed all persons from slavery, abolished feudal courts, and cancelled all payments not based on real property, including tithes.[73] Rents based on real property were redeemable. Once the law had been passed, the peasants seized the land and refused to pay any rents or redemption fees. In 1792 all payments were finally cancelled. Land of the clergy and political emigrants was confiscated and sold at auction, together with common land. The terms of sale often favored the wealthy, which may explain the rise of a new class of large landowners among the supporters of Napoleon.

There were other reforms in most European countries. England resolved its land problems by the enclosure movement, which drove the small peasants into the towns, consolidated landholdings, and promoted large-scale operation and private ownership. Sweden and Denmark pioneered between 1827 and 1830 by peacefully abolishing village compulsion, or imposed labour service, and the strip system of cultivation, by consolidating the land, and by dividing the commons among the peasants. Though influenced by the French Revolution, only after the 1848 revolutions did Germany, Italy, and Spain free the peasants and redistribute the land. Reform in Ireland took a whole century before substantive results were

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72 History of land reform, Modern European reforms, Encyclopaedia Britannica, Britannica.com editors, http://www.britannica.com/eb/article?eu=109595&tocid=61985#61985.toc

73 Tithes means 10% of the product of the rural land that was paid as a rent (or tax) to the feudal landlord.

achieved in the mid-1930s, after Ireland was divided into Northern Ireland and the Irish Free State. The tenants were converted into owners by subsidized purchase of the land.

The first major Russian reform was the emancipation of the serfs in 1861. At the time of emancipation about 45 percent of the land was private property and the remainder was held as allotment land, cultivated in units averaging 9.5 acres by the peasant serfs. In contrast, fewer than 1,000 noble families owned about 175,000,000 acres and received rent therefrom.

Conflict between such extremes of poverty and wealth caused restlessness among the peasants and rendered reform inevitable. As Tsar Alexander II put it: "It is better to abolish serfdom from above than to await the day when it will begin to abolish itself from below." The Emancipation Act of 1861 abolished serfdom and distributed allotment land among the peasants. The peasant paid redemption through the village authority, while the landlord received state bonds as compensation equal to 75 to 80 percent of the land market value. Though legally freed, the private serf had to ransom his freedom by surrendering a part of the allotment land.

By decree in 1918, the Soviets abolished private ownership of land, made farming the sole basis of landholding, and declared collectivization a major objective of policy. Marketing of agricultural products became a state monopoly. In 1929, Stalin embarked on a full course of collectivization, and by 1938, collective farms occupied 85.6% of the land and state farms 9.1%.

Reform in Eastern Europe was complicated by the fact that most of the eastern European countries remained under foreign rule until the middle of the 19th century or later. In Hungary, the Decree of 1853 abolished the forced labour and feudal dues, freed the serfs, liberalized land transaction, and encouraged consolidation.

The Romanian reform of 1864 freed the serfs and distributed both the land and the redemption payments in proportion to the number of cows or oxen each peasant had. The Turkish government in the 1850s introduced formal emancipation in Bulgaria, but actual reform came in 1880, after independence. Each peasant, including sharecroppers and wage-workers, who had worked the land for 10 years without interruption, was entitled to the land he had cultivated. With the exception of Bulgaria, the distribution of ownership throughout most of Eastern Europe remained highly uneven. Political instability reached a dangerous point between the two world wars. Following World War II, the Eastern European countries established Communist governments with a strong tendency toward collective, cooperative, and mechanized agriculture.

Attempts to reform the agrarian structure have been made in most other countries, with varying degrees of seriousness. Land reform and agrarian reforms have become synonymous, indicating that reform programs have become more comprehensive and encompass much more than the reform of land tenure or land distribution. Reformers have often faced hard choices:

- To promote and sustain private ownership with inequality or to institute public or collective ownership with equality but with restrictions on the individuals' private interests.
- To spread employment by supporting labour-intensive, low-productivity techniques or to promote high productivity through capital-intensive, efficient methods.
- To pursue gradual "repair and maintenance" reform that is basically ineffective or to promote revolutionary, comprehensive, effective but disruptive reform.

In capitalist reforms, these contradictions have usually been resolved in favor of the first set of options; in socialist reforms, in favor of the second. Land tenure reform seems to have been of little significance in creating substantive economic change, although it has been important for improving the status of peasants and maintaining social and political stability.

Land redistribution programs have had limited success for several reasons. They often have deprived the farm of the former landlord's contributions without providing a substitute. They have inhibited mobility of labour by giving the peasant a stake in the land, though only in the form of an inefficient mini-farm. They frequently have threatened large, efficiently run farms and therefore have had to be compromised. They have provided compensation for the expropriated land and hence left wealth and income distribution largely unaffected. They have been conditional upon peasant participation in social and political activity and cooperative organization, even though the peasant was unprepared for these activities. Moreover, the redistribution of land has rarely been fortified by protective measures that could prevent re-concentration of ownership and the recurrence of crises. Nevertheless, major efforts have been expended by the Food and Agriculture Organization of the United Nations and other international bodies and by governments to devise viable frameworks for solving agricultural and rural problems emanating from defective agrarian structures.

3.6 The Affect of the Growing Population on the Value of Land

Land could not be created or produced and its quantity is finite.[74] The perpetual growth in the world's population[75] decreases the amount of land per person.[76] This phenomenon increases the value of the existing land. The process of increasing the value of land is destined to continue as long as there is an increase in the number

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74 "The superior degree of civil liberty which prevailed in America contributed, without doubt, its share to promote the industry, happiness, and population of these states, but even civil liberty, all powerful as it is, will not create fresh land." Malthus, Thomas, Robert. An Essay on the Principle of Population, chapter 17, Western Washington University, http://www.ac.wwu.edu/~stephan/malthus/malthus.17.html

75 According to the U.S. Census Bureau, United States Department of Commerce, the official statistics, data of historical population in the world, In 1999 the population was 6,000,000,000 while only 300 years ago the population was about 600,000,000, that is 10 times less. See Table "A" - Historical Estimates of World Population http://www.census.gov/ipc/www/worldhis.html World population: 1950-2050 graph, See Table "B" http://www.census.gov/ipc/www/img/worldpop.gif

76 "Having developed technologies that transformed the earth, humankind now wonders about whether the planet and its resources can continue to sustain life. But the author sees that several modern technological trends are leading us toward a better, not worse, environmental future. He notes that we are using energy and land with increasing efficiency, and suggests that these trends may make human existence, even with population growth, less of a burden to the planet in the next century--if rapid growth in personal consumption and waste can be contained." Jesse, Ausubel H. Can Technology Spare the Earth?, American Scientist, The magazine of Sigma Xi, The Scientific Research Society, March-April 1996, Volume 84, No. 2. http://www.amsci.org/amsci/Articles/96Articles/Ausubel.html

of consumers interested in purchasing a "product" which is impossible to create - Land.

Growing population affects the rural land and the agriculture farms. Land ownership and tenure patterns are variable and complex. There are owners of large holdings who hire labour by wage or by shares. The majority is family-owners and workers of small plots, but large numbers of agricultural workers are land-less, working only for others. Many families own some land and at the same time work other plots by shares or for wages. The usual peasant holding is worked jointly by a father and his sons. When the father dies, the land, stock, and implements are distributed equally among the sons. This practice is the major cause of the small size of the individual peasant holdings.[77]

In order to prevent this phenomenon of shrinking agriculture farms, the Jewish ancient law forbids the distribution of rural land among the children of the deceased, and only the elder son could inherit the farm. This idea exists in the Israeli modern law, and only one child of the deceased can inherit an agriculture farm, and has to pay the others the value of their shares in the inheritance. In the ancient world (Mesopotamia, Egypt) brother married his sister to avoid distribution of rural land.

The phenomenon of continuous growth in the value of land in cities increased since the industrial revolution, when a large population emigrated from the agriculture farms to the new industrial areas.[78] The increasing demand for a land in those cities raised its' prices and the outcome was small dwelling areas for the

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77 Primitive Culture, the village with internal specialization and exchange, Encyclopaedia Britannica, Britannica.com editors, http://www.britannica.com/eb/article?eu=118249&tocid=68791#68791.toc

78 "The 'over-population' came to light all at once, and could not, as in the manufacturing districts, be absorbed by the needs of an increasing production. New factories could always be built, if there were consumers for their products, but new land could not be created. The cultivation of waste common land was too daring a speculation for the bad times following the conclusion of peace." Engels, Frederick. The Condition of the Working Class in England, The Agricultural Proletariat, p. 372. Electric Book, London, 1998, (First edition 1845), http://www.elecbook.com/workclas.zip

workers.[79] Immigration influenced the value of rural land and farms.[80]

The linkage between the size of population and "size" of land is inevitable. Scholars often wonder what is the natural limit to the population growth.[81] The continuous growth of population leaves less land per person. Since one needs his space for dwelling and work, we witness a massive usage of land in the mega-cities, where new buildings become skyscrapers of 80, 100 and more stories, that are enabled by the modern technology and the invention of the elevator.

A plot of 5,000 m^2 in the center of mega-city may contain 50,000 m^2 of built up area and even more and it may provide dwelling or working zone for a few thousand people. Such land may cost as much as 50,000,000 m^2 of rural land -- 1,000 times more, because it provides 1,000 times more population.

One human generation may be considered as 25 years. The population in the year 2025 will become as large as 8,470,000,000[82] that mean increase of about 40% to the year 2000.[83] The result is that the average price of a tract of land may increase

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79 "Leeds lies as the *Artisan* describes it, and as I found confirmed upon examination: ...An ordinary cottage in Leeds occupies not more than five yards square of land, and usually consists of a cellar, a living-room, and one sleeping-room." Engels, Ibid, pp. 99-101.

80 "When the industrial workers withdrew from agriculture, a great number of small holdings fell idle, and upon these the new class of large tenants established themselves, tenants-at-will, holding fifty, one hundred, two hundred or more acres, liable to be turned out at the end of the year, but able by improved tillage and larger farming to increase the yield of the land." Engels, ibid, p. 59.

81 "Assuming then, my postulata as granted, I say that the power of population is indefinitely greater than the power in the earth to produce subsistence for man. Population, when unchecked, increases in a geometrical ratio. Subsistence increases only in an arithmetical ratio. A slight acquaintance with numbers will shew the immensity of the first power in comparison of the second. By that law of our nature which makes food necessary to the life of man, the effects of these two unequal powers must be kept equal. This implies a strong and constantly operating check on population from the difficulty of subsistence. This difficulty must fall some where and must necessarily be severely felt by a large portion of mankind." Malthus, Thomas, Robert. An Essay on the Principle of Population, chapter 1, p. 11, ibid.

82 Population Information Network (POPIN) Gopher of the United Nations Population Division, Department for Economic and Social Information and Policy Analysis. World population growth from year 0 to stabilization, gopher://gopher.undp.org:70/00/ungophers/popin/wdtrends/histor

83 According to projection by the United Nation Population Division, in the year 2025 will se further increase to 8.5 billion people. Keyfitz, Natan. The Growing Human Population, in Managing

during this period in 40% as well.

The first question is whether the land can support life to 8.5 billion people,[84] and the second one is -- what is the limit of growth? It is predicted, that the growth of population will cease in the year 2150 with 11.6 billion people,[85] whilst on the year 2050 the population will be 10.2 billion people. That means that the next 25 years we will face the fastest growth in the population of human history, and it might be the fastest growth in the value of land in the human history.[86]

"It will be observed, that I have said in a progressive country; that is, in a country which requires yearly the employment of a greater capital on the land, to support an increasing population. If there were no question about fresh capital, or an increase of people, and all the land were good, it would not then be true that corn must be sold at its necessary price. The actual price might be diminished; and if the rents of land were diminished in proportion. The cultivation might go on as before, and the same quantity be produced it very rarely happens, however, that all the lands of a country actually occupied are good, and yield a good net rent. And in all cases, a fall of prices must destroy agricultural capital during the currency of

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Planet Earth: readings from Scientific American magazine, W. H. Freeman and Company, New York, 1990, p. 61.

84 "Famine seems to be the last, the most dreadful resource of nature. The power of population is so superior to the power in the earth to produce subsistence for man, that premature death must in some shape or other visit the human race. The vices of mankind are active and able ministers of depopulation. They are the precursors in the great army of destruction, and often finish the dreadful work themselves. But should they fail in this war of extermination, sickly seasons, epidemics, pestilence, and plague, advance in terrific array and sweep off their thousands and ten thousands. Should success be still incomplete, gigantic inevitable famine stalks in the rear, and with one mighty blow, levels the population with the food of the world. Must it not then be acknowledged by an attentive examiner of the histories of mankind, that in every age and in every State in which man has existed, or does now exist, That the increase of population is necessarily limited by the means of subsistence." Malthus, Thomas, Robert. An Essay on the Principle of Population, chapter 7, p. 54, ibid.

85 See Table "B".

86 "Profits might even increase, because the population increasing, at a more rapid rate than capital, wages might fall; and instead of the value of one hundred quarters of wheat being necessary for the circulating capital, ninety only might be required: in which case, the profits of stock would rise from fifty to fifty-seven per cent." Ricardo, David. An Essay on Profits, 1815. London: Printed for John Murray, Albemarle St., McMaster University, Faculty of Social Sciences, http://socserv2.socsci.mcmaster.ca/~econ/ugcm/3ll3/ricardo/profits.txt

leases; and on their renewal there would not be the same power of production."[87]

The intensive increasing value of land phenomenon creates a substantial capital gain should the owner of the real estate sell his property. That capital gain is the target to impose taxes on and increasing the government's income.

3.7 Sumer - the First City[88]

"World history is city history. Ante-dating Babylon, city history begins in Ur, the Babylonian port at the juncture of the Euphrates and Tigris rivers."[89]

In the 18th Century 10% of the world population lived in cities. In 1980, 25% lived in cities, and in 2000, 50% of the world population are living in cities according to various estimates. This phenomenon of emigration from the country to the cities began in Sumer.

Sumer was found in Mesopotamia. The meaning of Mesopotamia is a land between the rivers. Sumer developed a civilization in ancient times - perhaps the first civilization.[90]

History - Sumer may very well be the first civilization in the world. From its beginnings as a collection of farming villages around 5000 BC, through its conquest by Sargon of Agade around 2370 BC and its final collapse under the Amorites around 2000 BC, the Sumerians developed a religion and a society which influenced both their neighbors and their conquerors. Sumerian cuneiform, the earliest written language, was borrowed by the Babylonians, who also took many of their religious beliefs. Traces and parallels of Sumerian myth can be found in Genesis.

Sumer was a collection of city-states around the Lower Tigris and Euphrates rivers

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87 Malthus, T. R. An Inquiry into the Nature and Progress of Rent, and the Principles by which it is regulated, 1815, p. 34, footnote 14, Printed for John Murray, Albemarle Street 1815, Electric Book Company, London, http://www.elecbook.com/malrent.zip

88 Kramer, Samuel, Noah. History Begins at Sumer: Thirty-Nine Firsts in Recorded History. University of Pennsylvania Press, also, http://www.crystalinks.com/sumer.html

89 Schneider, Wolf. Babylon is everywhere, English edition, 1963, Hodder & Stoughton Ltd. p. 18.

90 See "the map of Sumer" in the appendix of pictures, picture 1.

in what is now southern Iraq. Each of these cities had individual rulers, although as early as the mid-fourth millenium BC the leader of the dominant city could have been considered the king of the region.

The earliest known writing comes from Uruk and has been dated to about 3,300 BC. It took the form of 'word-pictures' drawn with a stylus on tablets of damp clay. Each word-picture represented an object. Much later, the complete system had more than 700 signs. Writing developed as a convenient way to keep records of produce and accounts of trade. It much later became used to record literature and history. The word-pictures from Uruk developed into the script now called cuneiform. The pictures gradually became 'ideographs', an object also meaning an 'idea'. Then came 'phonograms' representing sounds as well as the meaning of a picture.

Cuneiform was a syllabic script with hundreds of wedge-shaped signs that developed from these pictures. The Sumerians were the earliest to write in cuneiform, closely followed by the Assyrians, Babylonians, Elamites, Hittites, Hurrians and the Urartu from Anatolia. Cuneiform was the language of politics until the fifth century BC. It died out and was replaced by the 22 letter Aramaic in about 900 BC.[91]

The Sumerians were probably the first people to make a calendar. They used the phases of the moon, counting 12 lunar months as a year. To make up for the difference between this year and the year of the seasons, they inserted an extra month in the calendar about every four years. The early Egyptians, Greeks, and Semitic peoples copied this calendar. Later the Egyptians worked out a calendar that corresponded almost exactly to the seasons by inserting 7 extra months in the calendar about every 19 years.[92]

Society - The people of Sumer worked as pottery makers, stonecutters, bricklayers, metal-smiths, farmers, fishers, shepherds, weavers, leather-workers, and sailors. Sumerians ploughed with stone and cut with clay sickles, and went on

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91 The Hebrew alphabet is based on the Aramaic one, and it contains 22 letters and 5 suffix letters.

92 This sort of calendar exists today in the Jewish society and is used in Israel side by side with the Christian calendar.

to using metal ploughs with the development of metalworking skills. A significant invention was the wheel, which at first was made of solid wood. The wheel was invented for carts, chariots, and pottery making.

Below the king or governor of Sumer, society had three distinct classes: aristocratic nobles, a middle class, and slaves. The aristocratic nobles were administrators, priests, and officers in the army rewarded with large estates. The middle class contained business people, schoolteachers, artisans, and farmers. The slaves, who had been captured in war or were dispossessed farmers or those sold by their families. Slavery was not stigmatized by race but was considered a misfortune out of which one could free oneself through service, usually in three years.

As the pastoral people traded with the farmers and villagers, complex social organizations could function more productively. The manufacturing of pottery and other products led to specialization and trading by barter, as the Sumerians had no money system except for the weighing of precious metals. As irrigation systems became more complex, planners and managers of labour were needed.

Seals had been used to stamp a carved insignia on clay before cylindrical seals became widespread for labeling commodities and legal documents.

Pictographic writing was first used by the Sumerians about 3400, and by 3000 BC this had evolved into cuneiform words and syllables. The Sumerian economy was based on agriculture, which was influenced by major technological advances in Mesopotamian history. Early Sumerian homes were huts built from bundles of reeds, which went on to be built from sun-baked mud bricks because of the shortage of stone.

Law - Laws made clear distinctions between the three classes. Though women had some rights, they were not equal to men. The Sumerians were quite bureaucratic, documenting major transactions and legal agreements of all kinds, being the first to develop a system of laws, which influenced the law codes of Hammurabi.[93]

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[93] Hammurabi was the sixth king of the first Babylonian dynasty. The "Letters and Inscriptions of Hammurabi" describes the reign of the Babylonian ruler of 4000 years ago. Souvay, Charles L. Transcribed by Kofron, W. G. Hammurabi, The Catholic Encyclopedia, http://www.newadvent.org/cathen/07125a.htm.

Hammurabi's Law Code was the earliest known law code in existence. The Code has 282 provisions, which dealt with many aspects of life, including family rights, trade, slavery, tariffs, taxes, prices and wages. The Code is inscribed on a stone slab over 2 meters high. At the top, the King is shown receiving laws from the Babylonian sun god, Shamash. The laws are not the same for rich and poor, but the weak were given some protection against the tyranny of the strong. The code was based on retribution, not justice and varied unfairly between social classes.[94]

Religion - The religion of the ancient Sumerians has left its mark on the entire Middle East. Not only are its temples and ziggurats scattered about the region, but the literature, cosmogony and rituals influenced their neighbors to such an extent that we can see echoes of Sumer in the Judeo-Christian-Islamic tradition today. They built the temple Ziggurat.[95]

The head of the family of Gods of heaven and Earth was Anu. He was the Great Father of the Gods, the king of the Gods. His realm was the expanse of the heavens. His symbol was a star. He lived in Heaven and according to Sumerian texts came to earth either at times of great crisis accompanied by his spouse Antu.

The second and most powerful god of the Sumerian pantheon was Enlil. He was God of Heaven and Earth, firstborn of Anu (Heaven) in union with Ki (Earth), dispenser of kingship, chief of the assembly of the gods, father of gods and men, granter of agriculture, and lord of airspace.

Among other Sumerian gods, there is Ninhursag the queen of the mountain-head and the daughter of Anu but her mother was not Antu. Ishter, the second daughter of Anu and Antum is the goddess of love, procreation, and war. She is armed with a quiver and bow. Nanna is another name for the moon god Sin. He is the product of Enlil's rape of Ninlil. Nanna was the tutelary god of Ur, appointed as king of that city by Anu and Enlil. The goddess Inanna was the patron and special god of the ancient Sumerian city of Erech, the City of Gilgamesh. As Queen of heaven, she was associated with the Evening Star (the planet Venus), and sometimes with the Moon.

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94 The Code of Hammurabi Translated by L. W. King, Exploration Ancient World Culture, Readings from the Ancient Near East, http://eawc.evansville.edu/anthology/hammurabi.htm

95 See the Ziggurat in the appendix of pictures, picture 2.

Science - Sumerian scientific achievements were important to the modern world. Sumerians invented the wheel 3700 BC. Sumerians developed a math system based on the numeral 60, which was the basis of time in modern world. Earliest concepts in algebra and geometry were formulated. A system of weights and measures were developed which served the ancient world until the Roman period. Many of the constellations were mapped by the Sumerians. Sumerians developed a complex system of sewers and flush toilets to rid cities of waste and unhealthy affects of swamps. Sumerian invented the bronze metal.

3.8 The City in the 19th and 20th century

The greatest city of antiquity was Rome. This general model of city structure continued until the advent of the Industrial Revolution, although medieval towns were rarely as large as Rome.

In the course of time, commerce became an increasingly important part of city life and one of the magnets that drew people from the countryside. Cities became places where all classes and types of humanity mingled, creating a heterogeneity that became one of the most celebrated features of urban life.

3.8.1 The Industrial Revolution as the Accelerator of the City

The technological explosion that was the Industrial Revolution led to a momentous increase in the process of urbanization. Larger populations in small areas meant that the new factories could draw on a big pool of workers and that the larger labour force could be ever more specialized. This they did in the 20th century, when most cities became surrounded by rings of suburbs. It is speculated that one result of the continuing population explosion will be the creation, in the next 100 years, of megalopolises, concentrations of urban centers that may extend for scores of miles.[96]

The rapidly increasing complexity and mass of tasks involved in managing the needs of millions of citizens, developed needs for efficient and very rapid

96 "Urbanization", Encyclopaedia Britannica, Britannica.com editors, http://www.britannica.com/eb/article?eu=76401

communications and transport means, a uniformity and standardization of services available. The bigger the mega-city, the faster and more complex the means. The whole phenomenon brought about the advent of "fast food" information, culture, travels, TV zapping and so on a growing sense of information saturation.[97]

3.8.2 The Growth-Control Policies

Dwelling in the suburbs is nowadays a popular lifestyle of many people. The critics of sub-urbanization allege that this type of development has been the cause of increased traffic congestion, loss of important farmland, subsidized growth, and the decline of central cities.

Although growth-control policies can be found in many communities, there is no national "movement" in the sense of a unifying philosophy or an agreed upon set of strategies.

Efforts to limit sub-urbanization can generally be divided into two categories: "no-growth" and "slow-growth" policies. In general these have taken the form of rigid growth boundaries around cities, or various types of moratoria on development, such as limitations on building permits. Advocates of these measures believe that if they can stop the physical expansion of their community, or limit new construction, the landscape as it currently exists will be protected forever.

However, to the extent that these tactics work at all, they can succeed only at a very small scale, because growth has to take place somewhere. People will eventually need their own homes and automobiles. So this approach works only if nearby jurisdictions have a more relaxed attitude and can accommodate new development at moderate cost.

Such a strategy would be impossible to apply at the state level, because the cure would be worse than the illness in terms of job loss, long-distance commuting, and high housing costs.

Slow-Growth Policies - Policies designed to slow down the process of

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[97] Joye, P. Eight Themes Around Mega-Cities, chapter 3, Mega-cities, accelerators of Timeand History, http://www.pjoye.com/wef/page3.htm

urbanization, or to "manage" it from a central political office, are much more common. Some of the slow-growth tactics include minimum lot-size zoning and maximum lot-size zoning.

Minimum lot-size zoning - A local authority may enact requirements that prohibit construction on lots smaller than a certain size-frequently, depending on the nature of the community. The reasons for minimum lot-size regulations vary, and there are often hidden agendas behind the public rationale. In rural communities, lot-size regulation is simply an attempt by people already living there to ensure that the number of newcomers is limited by restricting the housing potential of undeveloped land.

The unstated goal of many lot-size regulations is usually to keep low-income individuals out of a community. In many communities, those already living there consider renters and mobile home owners "undesirable". Mandating minimum lot sizes per dwelling is an effective way to maintain the social order.

Ironically, such government planning has been a leading cause of suburban sprawl, because it has forced many communities to develop at lower densities than would have been the case in a truly competitive real estate market.

Maximum lot-size zoning - This approach is popular with the "new urbanists", who believe that people should live in compact communities built to pedestrian scale, not automobile scale.

However, as with minimum lot-size regulation, it is impossible for central planners to know more than the market knows about consumer preference. In short, people will go to great lengths to get the kind of neighborhood they want, regardless of what government planners prefer.

Policies designed to slow down the process of urbanization, or to "manage" it from a central political office, are much more common. The tendency is for urban areas to develop at densities less than required by regulation, while in rural areas the tendency is to develop at higher densities than planned for.

A "no growth" policy would be worse than problems created by urban and suburban sprawl in terms of job loss, long-distance commuting, and high housing costs. Policies to slow down or "manage" urbanization are much more common and effective.

3.8.3 Restoring Cities through Incentives

Critics of sub-urbanization argue that controlling the physical expansion of existing towns and cities will make them more livable. Actually, what most people really care about are education, taxation, public safety, traffic, and environmental amenities such as open space. Most growth-control strategies are either silent on these issues or actually making them worse.

High property taxes have a tendency to push people out of cities and also generate large pots of money that urban politicians then use for self-serving pork-barrel projects like light-rail or professional sports arenas. User fees ensure that there is a strong connection between what consumers pay and what they get in return.

Any city without a property tax would have a powerful advantage over suburban jurisdictions in attracting both homeowners and employers. Converting urban highways to electronic toll-ways, with higher rates at the peak period to eliminate traffic congestion, is the theory of "congestion pricing". When people are offered differential rates, they change their behavior, bringing supply and demand into balance.

As population grows, so do service demands. Keeping levy rate reasonable is the challenge. [98] The problem is that the state collects many land taxes while the local authorities have to carry the burden of the land development.

Local authorities have used many strategies to respond to this fiscal dilemma, including a growing use of development fees, ballot measures to override tax and spending caps, and competition for revenue-producing development. Cities have learned to pursue high-value tax-generating development projects such as office parks, and auto-malls that bring in more revenue than they cost to service, and that can cover their up-front infrastructure costs through development fees, assessment districts, and other creative financing mechanisms.[99]

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98 The Detroit News, May 24, 1999, http://detnews.com/specialreports/1999/taxes/mondemands/mondemands.htm

99 FACT SHEET: Land Use and State/Local Financing, in California Futures Network,

3.8.4 Urban-Suburban Migrations

Cities are traditionally thought of as the repositories of the nation's underclass, while suburbs are reserved for the more affluent. While some suburban communities have used zoning and other policy instruments to wall themselves off from the poor, in fact many lower-income people are moving to the suburbs while many upper-income suburbanites are moving back to the city. Why the role reversal?

For poor people, there are a number of reasons. First, jobs follow people, and since most people now live in the suburbs, that is where the major job expansion has been. This means that for lower-income individuals if they want more job opportunities they are better off moving away from the inner city.

Second, lower-income parents often place a high value on education, just as their richer counterparts do. When they know that their children will have better educational opportunities in the suburbs, they have a strong incentive to move there.

Thirdly, for most of the past century, the suburban migration has been strongly correlated with rising personal income. As people accumulate more wealth, they tend to desire more private space, and their growing affluence allows them to act on that preference. Since personal income has been rising across virtually all income classes, more people can now afford to live away from the inner city.

However, because large cities are becoming primarily recreation and cultural centers rather than job or residential centers, they attract certain demographic groups. These demographic groups including single professionals, who may commute out to the suburbs for work but prefer the social opportunities of the city, young married couples who are childless and thus unaffected by mediocre urban schools, and empty-nesters who now value urban cultural amenities more than a large suburban yard.

3.9 The Mega City

A Mega-City is a result of the process, by which large numbers of people become

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http://www.calfutures.org/resource/FSstateloc.html permanently concentrated in relatively small areas, forming cities. A mega-city is a multi million resident city, and this phenomenon started in the 20th century.

3.9.1 The Urban Explosion

The increasing number of mega-cities of more than eight million inhabitants illustrates in itself the major demographic and geographical trends of the past century. In 1950, only two cities, London and New York, were that size. In 1975, there were 11 mega-cities, including six in the industrialized countries. In 1995, there were 23, most of them (17) in the developing countries. In 2015, the projected number of mega-cities is 36, 30 of them in the developing world and most (22) in Asia.

Urbanization is taking place at different speeds on different continents. In North America, the number of city-dwellers overtook the rural population before the Second World War. In Europe, this happened after the war and in Latin America at the beginning of the 1960s. Today, these three continents are almost equally urbanized - 75% of Europeans and Latin Americans are city-dwellers and 77% of North Americans, according to UN estimates for the year 2000.[100]

A similar process is occurring in Africa and Asia, which are still mainly rural. Their proportion of city-dwellers rose from 25% in 1975, to 35% in 1995 and a little more than 37% today. The turning point, when the figure will top two-thirds of humanity, is predicted for around 2025.

In terms of numbers, the world's city-dwellers in 2025 should total 307 million in North America, 566 million in Latin America, 572 million in Europe, 752 million in Africa and 2,507 million (2.5 billion) in Asia. In 2015, the world's six biggest cities are expected to be Tokyo, Bombay, Lagos, Sao Paulo, Dhaka and Karachi.[101]

Experts say the rate of population growth will eventually decline everywhere, but

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[100] The Urban Explosion, in The Unesco Courier, The South's urban revolution, June 1999.

[101] The most populated cities nowadays are Amsterdam, Athens, Bangkok, Beijing, Berlin, Brussels, Budapest, Chicago, Hanoi, Helsinki, Hong Kong, Jakarta, Kuala Lumpur, London, Lisbon, Los Angeles, Madrid, Manila, Montreal, Moscow, New York, Osaka, Oslo, Paris, Prague, Rangoon, Rio de Janeiro, Rome, San Francisco, Sao Paulo, Seoul, Singapore, Stockholm, Sydney, Taipei, Tokyo, Vancouver, and Vienna.

once again at very different speeds. Between 2005 and 2010, annual population growth rates are predicted to be 3.82% in Africa, 2.59% in Asia, 1.68% in Latin America, 1.06% in North America and 0.24% in Europe.

3.9.2 Are Mega-Cities an Aberration?

Aristotle saw a definitive limit to the growth of cities. The Greeks should know. They invented the social concepts of the modern city, the citizenship, and voting. In order for these to work, the limit was put at 6,000 inhabitants. More inhabitants would bring severe social and communication problems. The city, "Polis", had actually been created by the Greeks to facilitate communication in a growing web of social intercourse.

In 1,500 BC., Babylon counted some 300,000 inhabitants. In 200 BC., Rome was a mega-city of 800,000 inhabitants. In the 18th Century, everyone was convinced that a city could not contain more than 700,000 inhabitants. In the 19th and 20th Centuries, it was common sense to admit that cities could, thanks to ceaseless technological and urban innovations, grow indefinitely.

Today cities seem to become entities of their own, detached from the countries in which they exist, suffering from physical, chemical, social and cultural entropy. The Mayor of Tokyo, Mr. Suzuki, said in 1992: "The 20th Century was that of urbanization, the 21st Century will be that of the mega-cities".

The exponential increase of all constituting parts of the mega-city (population, immigration, social decline, infrastructure maintenance, insecurity, violence, and so on) will inevitably lead to an explosion of the city, in the apocalyptic definition of the word. Mega-cities tend to actually develop a life of their own, influencing in unpredictable and sometimes unexplainable ways the individuals living in them.

3.10 Mega Cities in the 3rd Millenium

In the year 2015, there will be 30 mega-cities with more than 8 million inhabitants, most of them in Asia. How will they cope?[102]

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[102] Jacot, Martine. Living with Leviathan, in The Unesco the Courier, June 1999.

Humanity is about to set a new record. Nearly two thirds of the planet's globalization gives shape to the "global village" predicted by the Canadian Marshall McLuhan. By 2025, two-thirds of humanity will be living in cities and towns, where the best opportunities in life tend to be.[103]

World population, according to the same projections, will top 8 billion in 25 years' time, including five billion in cities. The increase will be particularly spectacular in the cities of the developing world, whose total population will double to four billion. We are going to see an unprecedented exodus of people from rural areas. The flow of people into mega-cities in developing countries is well under way. However, the demographers' predictions are only tentative.

3.11 Conclusions

Since the first city Sumer, most of the population (about 90%) were peasants and produced agriculture. The ruling classes, soldiers, clerks, and merchants populated the cities. The industrial revolution caused a massive immigration from the rural zones to the modern cities. During the 19th and 20th centuries the population of the rural zones declined, and today only 3-4% of the population in the Western countries are working in agriculture.

Mega-cities that are populated by more than 8,000,000 people started to develop in the 20th century. In the year 2000 there are 26 mega-cities and its numbers are continuing to increase.

The land in those mega-cities is exploited massively by skyscrapers of more than 100 stories. While an average farm of 30,000 square meters supported dwelling and work to one family, a parcel of 3,000 square meters in mega-city can supply dwelling and work to hundreds of people.

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http://www.unesco.org/courier/1999_06/uk/dossier/txt11.htm

103 Wilheim, Jorge. Urbanization and Globalization, in The Unesco Courier June 1999. http://www.unesco.org/courier/1999_06/uk/dossier/txt18.htm

Chapter 4 The Profit

4.1 Definition

Profit is a positive gain from a business operation. The term "profit" like "income" means the difference between revenue and expenses, before taxes. Profit is part of the principles of economics.[104] [105]

Economics is a conversation that has been going on for over two hundred years. The conversation includes professional economists, citizens, managers, and others. The conversation began with Adam Smith's book "The Wealth of Nations." Smith's topic: Why do some countries have high standards of living? What makes nations wealthier?

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104 "In economics, return on capital, also called earnings, minus the costs of maintaining land, labor, and capital. It is also known as net income. Economic theorists generally make a distinction between two types of profit: normal profit, in which the entrepreneur receives the minimal necessary amount to encourage him to open or stay in a particular business; and excess profit, that which exceeds normal profit." The Columbia Encyclopedia, 6th Edition. 2001, http://www.bartleby.com/65/pr/profit.html

105 "Profit", in business, the monetary difference between the cost of producing and marketing goods or services and the price subsequently received for those goods or services. Profit is an essential competitive feature of buying and selling in the economic system. The opposite of profit is loss, whereby the cost of producing certain goods or services is higher than the price a buyer is willing to pay for them. Microsoft Encarta Online Encyclopedia 2001, http://encarta.msn.com

The profit is a result of combining three main components - land, labour and capital. Land is the original and indestructible powers of the soil - natural resources, such as coal, oil, and metallic ores. Labour is human action and is the resource from which most of us expect to earn our living. Capital consists of all goods produced by human labour, and used in the production of still more goods.

Adam Smith thought that increases in the division of labour were the most important source of increasing productivity. His most famous example was the "pin factory." More generally, when people work cooperatively, doing different jobs that reinforce one another, everybody becomes more productive and better off.

Smith thought that increasing division of labour was the most important source of increasing productivity in the long run. Most modern economists think that it is a technological progress. Really, division of labour and new technologies reinforces one another. For example, new technologies in communication and transportation will create new opportunities for division of labour.

At the beginning of the 19^{th} century economists and philosophers used to view the economy via the angel of agriculture, as it was at that time the main field of the economic system. David Ricardo saw the earth as the origin of wealth and profit, and divided it into three categories. The first category is the produce of the earth - all that is derived from its surface by the united application of labour, machinery, and capital. The produce of the earth is divided among three classes of the community; namely, the proprietor of the land, the owner of the stock or capital necessary for its cultivation, and the labourers by whose industry it is cultivated. In different stages of society, the proportions of the whole produce of the earth under the names of rent, profit, and wages, will be essentially different. It depends mainly on the actual fertility of the soil, on the accumulation of capital and population, on the skill, ingenuity, and instruments employed in agriculture.[106]

Ricardo divided the profit into three parts - the "proprietor of the land" meaning the rent, the "owner of the stock or capital" meaning the interest, and the

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106 Ricardo, David. Principles of Political Economy and Taxation, 1817, third edition 1821, preface, McMaster University, Faculty of Social Sciences, http://socserv2.socsci.mcmaster.ca/~econ/ugcm/3ll3/ricardo/prin/prin1.txt

"labourers" meaning the wages. The share of the profit of each one of those three, is an economic as well as social issue. The answer depends on the economic system - capitalistic, socialistic, or communistic; on the regime method - democratic or totalitarian; and on the personal point of view.

At the end of the 19th century, we can find a sophisticated attitude to the meaning of "profit" which was introduced by Alfred Marshall. "When a man is engaged in business, his profits for the year are the excess of his receipts from his business during the year over his outlay for his business. The difference between the value of his stock of plant, material, etc. at the end and at the beginning of the year is taken as part of his receipts or as part of his outlay, according as there has been an increase or decrease of value. What remains of his profits after deducting interest on his capital at the current rate (allowing where necessary, for insurance) is generally called his earnings of undertaking or management. The ratio in which his profits for the year stand to his capital is spoken of as his rate of profits."[107]

Joseph Schumpeter wrote about this issue at the beginning of the 20th century. "We seem to be faced by this alternative: either we are to assume social utility curves,--in which case society must be the sole owner of capital and land, the society is communistic, and no rent or interest will be paid to individuals; or rent and interest are paid, in which case there are no social values, but only individual ones, and society as such does not control production. It may still be held that the final results are the same as they would be if society were in control; and this theory we shall further discuss."[108]

In his book that was published after his death, Schumpeter referred to Ricardo and wrote: "The sum total of the gains of the business class, the theoretical type of which, with the Ricardians, was the farmer."[109]

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107 Marshall, Alfred. Principles of Economics, An introductory volume, 1890, Book II: Chapter 4 Income, Capital. Universite Paris 1, CHPE Centre d'Histoire de la Pensée Economique, http://panoramix.univ-paris1.fr/CHPE/Textes/Marshall/Principles/

108 Schumpeter, Joseph. On the Concept of Social Value, Quarterly Journal of Economics, volume 23, 1908-9. Pp. 213-232. http://socserv2.mcmaster.ca/~econ/ugcm/3ll3/schumpeter/socialval.html

109 Schumpeter, Joseph. History of economic analysis, George Allen & Unwin Ltd., sixth printing 1967, p. 645.

4.1.1 Positive and Normative Economics[110]

According to Milton Friedman,[111] positive economics has to do with "what is," while normative economics has to do with "what ought to be." Positive economics is a social science, and as such is subject to the same checks on the basis of evidence as any science. By contrast, normative economics has a moral or ethical aspect, and as such goes beyond what a science can say.

It is true that economics cannot rely on experimental methods to verify its hypotheses, in many cases. However, the same is true of some of the sciences, ranging from astronomy to ecology. These are observational sciences, and so is positive economics.

Let us illustrate the distinction and some of its pitfalls by an example. A person might say, "Everybody ought to be paid the same hourly wage, because it is just that each person should be rewarded in proportion to his labour." This is clearly normative economics it has to do with what should be.

Now, a "positive" economist might observe that this rule would be inefficient in the following sense. Some occupations require more training, more effort, or more talent than others or they are more responsible. If these occupations are better rewarded, they will be better performed, and overall productivity of labour will increase as a result. This increase in productivity will be more than enough to pay the higher wages for the skilled, talented, effortful and responsible occupations, with something left over that might make everyone better off. This is positive economics so far as it goes, and like any proposition of positive science, it might be either true or false.

But suppose it is true, and suppose the "positive" economist goes on to say that because equal wages are inefficient, wages should not be equalized. That would be normative, not positive economics, and it would be fallacious. The normative economist can respond with perfect logic that justice is more important than a reduction in output, which may well be quite modest. There is a hidden

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110 Essential Principles of Economics: A Hypermedia Text in The journal of Economic Education, http://william-king.www.drexel.edu/top/prin/txt/Ecotoc.html

111 Milton Friedman is a conservative social philosopher and economic theorist and statistician.

assumption, and the assumption is that people "ought" to value production over equality of reward, and there is no logical reason why they should not.

What the positive economist can do is spell out the consequences of a rule such as equal pay. This is important, since rules always have consequences that are hard to anticipate. If we understand the consequences, we may want to reconsider our support for the rule. But the rules we propose, and the consequences we are interested in, depend upon our values. Not all consequences are equally important. In the last analysis, positive economics is the servant of normative economics.[112]

In this chapter I will deal with the three "partners" that share the profit and the wealth provided by the earth - the wages of the labourer, the interest on the money (means stock and capital), and the rent for the land. In this chapter, I will not deal with the entrepreneurial profit, that is a surplus over costs.[113]

4.2 Wages - Profit for Selling Time (Labour)

The most precious property of man is time. An infant dedicates his time to learn basic skills, a pupil to learn basic studies, and a student and an apprentice to learn a profession. Man should eat, sleep, raise his family, and take care of his health and his lifestyle. The rest of the time may be dedicated to support himself and his family.

One may say that this description does not fit those who should support

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112 An important point of view is presented by be Matthew Josephson in his book The Robber Barons. The author describes the Barons in the context of the political, social, and industrial trends of the time. It tells the story of the massive industrialisation of America that occurred in the last quarter of the 19th century. It was the greatest boom of them all, generating a giant interlocking system that covered steel, oil, railways, coal, food processing and banking. It describes how they were shaped by the industries they were in, and by the competitive forces set in motion by each other. The book was written in 1934 in the depths of the Great Depression, when many people questioned their faith in the free market system.

113 "The most important theories of profits may be characterized by the following terms: friction theory, risk theory, differential rent theory. I refer to the discussion of them in Wesen, bk. III, and shall not here enter into a critique of them. At the same time J. B. Clark, whose theory is nearest to mine, may be cited here; cf. His Essential of Economic Theory." Schumpeter, Joseph. The Theory of Economic Development, An Inquiry into Profits, Capital, Credit, Interest, and Business Cycle, Harvard University Press, 1959, 6th printing, p. 128.

themselves, even if they have to neglect their other basic needs. This criticism is partly correct for a land leaser in feudal regime, an employee in a factory at the beginning of the industrial revolution, a slave, and others that do not live in modern democratic countries, but is correct for a man that was born free and is capable to choose.

An employee can sell this precious property to his employer; a service provider can sell it to his clients, and a merchant to his customers. No matter who is the seller and who is the buyer, the time is sold for the benefit of a profit.

Ricardo described the labour and the wages in a similar way: "Labour, like all other things which are purchased and sold, and which may be increased or diminished in quantity, has its natural and its market price. The natural price of labour is that price which is necessary to enable the labourers, one with another, to subsist and to perpetuate their race, without either increase or diminution... The market price of labour is the price, which is really paid for it, from the natural operation of the proportion of the supply to the demand; labour is dear when it is scarce, and cheap when it is plentiful. However, much the market price of labour may deviate from its natural price, it has, like commodities, a tendency to conform to it."[114]

Adam Smith discussed the influence between the demand for labour, the cost of life, the direct tax upon the wages, and the wages of the workman. "The ordinary or average price of provisions determines the quantity of money, which must be paid to the workman in order to enable him, one year with another, to purchase this liberal, moderate, or scanty subsistence. While the demand for labour and the price of provisions, therefore, remain the same, a direct tax upon the wages of labour can have no other effect than to raise them somewhat higher than the tax."[115]

Most of those dilemmas belong to the past. In the western countries, labourers are

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114 Ricardo, David. The Iron Law of Wages, 1817, Fordham University, Modern History Sourcebook, From The Works of David Ricardo, J. R. McCulloch, ed. (London: John Murray, 1881), pp. 31, 50-58. http://www.fordham.edu/halsall/mod/ricardo-wages.html

115 Smith, Adam. The Wealth of the Nations, book 5, chapter II, article III - Taxes upon the Wages of Labour, p. 25, Bibliomania: Free World Literature online, http://www.bibliomania.com/2/1/65/112/frameset.html

members in unions with political influence, and the law protects and sometimes over protects their rights. Yet, those arguments are in use nowadays more than ever.

4.2.1 Karl Marx[116]

Karl Marx saw capitalism as a society divided between two classes, the working class, producers of all value, and the owning and employing class, exploiter surplus value. For Marx, the fundamental fact about capitalism was the class struggle between the working class and the employing class over surplus value.

Surplus value and exploitation took a specific form in a capitalist society, but had existed long before capitalism. Marx claimed that all history should be thought of as the history of class struggles over surplus value. That is, the theory of surplus value is a theory of history.

No classes or surplus value existed in prehistoric times, however, early societies were undeveloped, and as a result their labour-productivity was so low that they could produce only enough to assure the reproduction of the tribe or band. In these circumstances they practiced "primitive communism."

This was necessary for survival: if each person did not produce according to her or his ability, and share with others according to their needs, the group would not survive as a group, and no individual could survive for long without the group.

Thus there could be no exploitation, and these early societies (Marx guessed) would be equalitarian and free, albeit very poor. There is a good deal of anthropological evidence consistent with Marx' guess on this point.

The earliest historic stages of society Marx spoke of as "slave" societies.[117] Marx

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[116] Essential Principles of Economics: A Hypermedia Text in The journal of Economic Education, http://william-king.www.drexel.edu/top/prin/txt/Ecotoc.html

[117] "In the first place, the rise of wages leads to overwork among the workers. The more they want to earn the more they must sacrifice their time and freedom and work like *slaves* in the service of avarice. In doing so, they shorten their lives. But this is all to the good of the working class as a whole, since it creates a renewed demand. This class must always sacrifice a part of itself if it

was thinking of classical Greek and Roman society, in which slavery played a relatively large role; but our evidence suggests that the role of simple slavery varied widely among early civilizations. The basic unit of society was the city, town or village, and stronger communities extracted surplus from weaker ones by threat.

Slavery was just one form that tribute might take, and in many cases slaves were the collective property of the city. Tribute is due from a person as a member of a defeated group to another person as a member of a triumphant group. Tribute is legitimated theft -- the payer renders tribute in order to avoid violent attack, as the slave works to avoid violent attack by her or his master.

This sort of society is hierarchical, in that smaller and weaker towns pay tribute to middling cities that pay, in turn, the larger and stronger cities their tribute. The hierarchy may be reproduced within the city communities, especially the bigger and stronger ones. Emperors and tyrants rule over mere citizens as great towns rule over villages. But not always -- our classical examples of democracies are cities in which the citizen-fighters are equals among themselves, benefiting from the tribute and labour of non-citizen slaves and villagers.

Because agricultural societies can produce a significant surplus over what the farmer must eat to work and survive, tribute and slavery become the basis of life for the non-working class, which includes not only soldiers and rulers but also poets, scholars, scientists, craftsmen, artists, physicians, priests, and philosophers. In brief, the extortion system was the basis of civilization. But that civilization collapsed and was replaced, in many parts of the world, by a new system called "feudalism."[118]

For Marx, the next and intermediate stage was feudalism, well known from

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is to avoid total destruction. " Marx, Karl. Economic and Philosophical Manuscripts, First Manuscript, Wages of Labour, Marxists Internet Archive: Encyclopedia of Marxism http://www.marxists.org/archive/marx/works/1844-epm/1st.htm

118 "For, to our three social reformers, the bourgeois world, based upon the principles of these philosophers, is quite as irrational and unjust, and, therefore, finds its way to the dust-hole quite as readily as *feudalism* and all the earlier stages of society." "Utopian communism", Encyclopedia of Marxism: Glossary of Terms, http://www.marxists.org/glossary/terms/c/o.htm#utopian-communism

European history. In theory, exploitation in feudal society is based on ownership of land. Of course, the landowners have the means of violence, and violence is used to enforce their ownership of land, but it is no longer simply violence to obtain tribute -- rather violence to enforce property in a certain kind of resource.

The stage is then set for an exchange: resource for resource, land for labour. But this exchange can never be equal: the serfs have no means of life in an agrarian society and must offer their labour in exchange for access to land on what terms they can get. Those terms are so poor that landowners become the beneficiaries of "privilege," that is, private law.

Landowners are the state; it makes no sense for the state to pay taxes to itself; therefore landowners pay no taxes. And workers may be deprived of the freedom to move, bound to the land, and even bought and sold little differently than slaves.

At the same time, feudalism is more individualistic than the tribute (slave) society. A village community may still pay tribute, but it is paid to an individual landlord, and increasingly it is a matter of the exchange of labour service for access to land on an individual basis. This individualism in the ruling landowner class correlates with the highly fragmented nature of feudal society, but it also leads to the first real conception of freedom. The landlord is free, a sovereign individual whose relation to others in his class is essentially reciprocal, and this is the concept of freedom that moves modern society.

Feudalism is a class system. There is a class of landlords, and a class of land-less farmers. The landlords do not work at farming. They are fighters, and in theory, it is their job to protect the farmers from any attempt at extortion or enslavement by other fighters.

The compromise between the two classes is that the farmers spend part of their time working on the landlord's land, and in return the village gets access to a supply of land they may work for their own food. In addition to this exchange of land for labour, the landlord "protects" the village and the village supports the landlord's fighting with loyal service. Thus, land is not simply the landlord's property.

The village has rights, and individual villagers have rights in it as members of the village community. Conversely, the landlord has rights in the labour of the village, and the villager may not be allowed to leave the village community without the landlord's permission. He is then a "serf," and in extreme cases such as that of Russia, the serf's status may be only slightly better than that of a slave. The non-working class of landlords was known as the nobility, or, in a term from Greek societies, aristocracy.

The two old classes, landlords and farmers, now faced a new "middle" class that relied much more on money and markets. The city with a wall, became a bourg (burg) and so the new class were called (in Marxist thinking) bourgeoisie (burgers). The cities were the beginning of capitalism, but at the beginning they were more feudal in their way than capitalist.

Capitalism was emerging, but it required two things. One was the emergence of national states. The national state is, essentially, a feudal city extended to the territory of the nation, with its own paid army of mercenaries or professional national forces, and taxation on individuals to pay for this army.

In England, in the English revolution, a paid national army of the English Republic met the aristocratic army of English feudalism and beat it. When the English monarchy was restored, it simply adopted the army of the republic, red coats and all. In France, the king created the national army. Either way, the existence of a national army meant the divorce of the landlord class from its special function as fighters.

The second step was to eliminate the special rights of the landlords and the village community in land. In France, that took place in the revolution of 1789, when the villagers simply took the land as individual property. In England, the landlord class was transformed into a class of capitalist landowners who rented their land for money.

Thus, feudalism gave way to capitalism. Still, the hand of violence is concealed behind and restrained by a system of property. But property is abstracted. It is property in general -- not in a specific resource, such as land -- that is enforcing by governmental violence, and forms the basis for exploitation. Conversely, the connection between the exploiter and the worker is no longer an exchange of resource for resource, but an exchange of resource (labour) for money.

The exploiting class requires the working class, but the working class does not require exploiters, and eventually will dispense with them, organizing production for its own benefit as a class. This new society is "socialism." Capitalism replaced feudalism through a series of revolutions, in which the class of "capitalists" or "merchants"[119] fought and defeated the class of landlords. The emergence of the new socialist society will be no fewer revolutionaries in all probability. But these new revolutions will mark the end of the historic tale of classes, exploitation and surplus value, and a return to the equality of prehistoric societies -- but without the poverty they had to endure.

4.3 Interest - Profit for Using Money, Stock, and Capital

"Interest" - the fee charged by a lender to a borrower for the use of borrowed money, usually expressed as an annual percentage of the principal; the rate is dependent upon the time value of money, the credit risk of the borrower, and the inflation rate.[120]

The legal definition for "interest" is the financial amount paid by someone else for the use of a person's money, as on a loan or debt, on a savings account in a bank, on a certificate of deposit, promissory note or the amount due on a judgment. Interest is usually stated in writing at the time the money is loaned. There are variable rates of interest, particularly on savings accounts, which depend on funding from the Federal Reserve or other banks and are controlled by the prevailing interest rates on those funds. Maximum interest rates on loans made by individuals are controlled by statute. To charge more than that rate is usury, the penalty for which may be the inability of a creditor to collect through the courts. The interest rates demanded by lending institutions are not so restricted. The law

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119 "Civilization consolidates and intensifies all these existing divisions of labor, particularly by sharpening the opposition between town and country (the town may economically dominate the country, as in antiquity, or the country the town, as in the middle ages), and it adds a third division of labor, peculiar to itself and of decisive importance: it creates a class which no longer concerns itself with production, but only with the exchange of the products -- the *merchants*." "Division of Labour" Encyclopedia of Marxism: Glossary of Terms, http://www.marxists.org/glossary/terms/d/i.htm#division-labor

120 "Interest", Investor-words, the biggest, best investing glossary on the web, InvestorGuide.com, Inc. http://www.investorwords.com/

of the state sets the maximum legal interest often granted by the courts on judgments. Simple interest is the annual rate charged for a loan, and compound interest includes interest upon interest during the year.[121]

Marshall defined the interest as "The payment made by a borrower for the use of a loan for, say, a year is expressed as the ratio which that payment bears to the loan, and is called interest."[122]

Schumpeter referred to interest as a part of common economic system. "Interest on business loans is nothing but a normal business profit transferred to lenders… normal business profit itself is nothing but the return on the physical means of production, labour's means of subsistence included."[123]

Nicholas Barbon used a special illustration. "Interest is the rent of stock, and is the same as the rent of land. The first, is the rent of the wrought or artificial stock; the latter, of the unwrought or natural stock."[124] Barbon describes the linkage between interest and rent. Another use of interest is the measure of the value of the rent of land. It sets the price in buying and selling of land. He explains the height of the interest. Interest being so high in England, is the cause of the fall of rents. [125]

A historical lesson can be learned from an ancient legal system that intended to protect the peasants from bankruptcy and becoming a feudal society. "Moses, that wise law-giver, who designed that the land divided amongst the Jews, should continue in their families; forbid the Jews to pay interest, well knowing that the

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121 "Interest", The Real Life Dictionary of the Law, General Publishing Group, Inc. http://dictionary.law.com/

122 Marshall, Alfred. Principles of Economics, An introductory volume, 1890, Book II: Chapter 4 Income, Capital. Universite Paris 1, CHPE Centre d'Histoire de la Pensée Economique, http://panoramix.univ-paris1.fr/CHPE/Textes/Marshall/Principles/

123 Schumpeter, Joseph. History of economic analysis, George Allen & Unwin Ltd., 6th printing 1967, p. 327.

124 Barbon, Nicholas. A Discourse of Trade, Of Money, Credit and Interest. London, Printed by Tho. Milbourn for the Author, 1690. McMaster University in Canada, maintained by Robert Dixon in the Economic department of the University of Melbourne, http://melbecon.unimelb.edu.au/het/barbon/trade.txt Quoted by Schumpeter, Joseph. History of economic analysis, George Allen & Unwin Ltd., sixth printing 1967, p. 329.

125 Ibid, Of the Chief Causes of the Decay of Trade in England, and Fall of the Rents of Land.

merchants of Tyre, who were to be their near neighbors, would, by lending money at interest, at last get their lands. And that this seems to be the reason, is plain; For the Jews might take interest of strangers, but not pay; for by taking interest, they could not lose their estates."[126]

Whether the interest is high or low, it is the target to attack the money loaner ("loan sharks" in American slang) and to attach them a social stigma.[127]

4.4 Rent - Profit for Using Land

4.4.1 Definition of Rent

"Rent" is a periodic payment by a tenant for the use of another's property i.e. real estate (land and buildings).[128] The term rent applies as well to the payment for the use of moveable products.

In economics, its meaning is more complex, but since the word rent means any income or yield from an object capable of producing wealth, its limitation to a more special sense is somewhat arbitrary and justified only by a general consensus of opinion and usage.

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126 ibid.

127 Shakespeare, William. The Merchant of Venice, the character of Shylock.

128 The term "Rent" is defined by various dictionaries and glossaries: "This is the consideration paid by a tenant to a landlord in exchange for the exclusive use and enjoyment of land, a building or a part of a building. Under normal circumstances, the rent is paid in money and at regular intervals, such as the first of every month. The word has also come to be used as a verb as in to "rent an apartment", although the proper legal term would be to "lease an apartment." Duhaime's Law Dictionary, Duhaime & company, http://www.duhaime.org/diction.htm. "The consideration paid for the right to use and possess property. A certain profit in money, provisions, chattels, or labour, issuing out of lands and tenements in retribution for the use." The Lectric Law Library Reference Room, http://www.lectlaw.com/ref.html. "Payment, usually monthly, for use of space or property." Investors Words the biggest, best investing glossary on the web, InvestorGuide.com, Inc. http://www.investorwords.com/ "A fixed, periodic payment made by a tenant of a property to the owner for possession and use, usually by prior agreement of the parties." Buyers' Resource Glossary, http://homes.inresco.com/Bglossary.html

The term rent is now ordinarily used in the broad sense and besides the return from land, includes the return from such things as tools, machinery, and houses. Objects are rented for a limited period of time and are generally expected to be returned in their original condition.

The early English writers on economics (16th–18th cent.) used the word to mean interest on a loan, but its economic meaning gradually narrowed to the sense of the return on land. Modern rent doctrine began in the 18th cent.[129]

"The tenure holder, or peasant, owed the seigneur two basic obligations, rent and services. Rents were highly variable, but services were usually still the greater burden. The basic services were agricultural labour on the demesne land, military duty, and craftwork. Agricultural labour, for example, might be calculated as three man-days a week per tenure holding. Since a family on a holding might be quite large, the three days could be divided among several men. Military duty would be highly variable because it would be a simple response to emergency -- ordinarily an 'all hands' response."[130]

The amount of rent paid reflects the devaluation of rental property, the interest paid to the banks to finance the purchase of the property, and the profit of the property owner. In fact, the rental fees are determined by the accepted market value of a rental fee of a similar property and the rate is influenced by supply and demand. Sometimes it can even be determined by the policy of various subsidies given by the state or other local councils that are leasing out similar properties owned by them. Rental rates can also be influenced by legislature, which often puts a ceiling on the rates.

4.4.2 The Theory of the Physiocrats upon Rent

The physiocrats centered their economic system on land. They believed that rent is measured by the "net product" i.e. the surplus over the cost of production. They

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129 "Rent", The Columbia Encyclopedia, Sixth Edition. 2001. http://www.bartleby.com/65/re/rent.html

130 Primitive Culture, the village with internal specialization and exchange, European peasant society, Encyclopædia Britannica, Britannica.com editors, http://www.britannica.com/eb/article?eu=118249&tocid=68791#68791.toc

believed in a free trade and in land and its products as the only true wealth. Because they identified wealth with fixed material objects, the physiocrats considered rent not as the variable yield from land but as a fixed value, which they called "current price of leases" and "disposable revenue".

Adam Smith attempted to formulate a "natural rate" of rent based on the laws of supply and demand. This rate would be an amount high enough to induce the landowner to keep his land in cultivation and low enough to allow the tenant to subsist. Smith referred to the rent as a profit or interest for the investment of the landlord: "Rent, considered as the price paid for the use of land, is naturally the highest which the tenant can afford to pay in the actual circumstances of the land… The rent of land, it may be thought, is frequently no more than a reasonable profit or interest for the stock laid out by the landlord upon its improvement."[131]

David Ricardo held that demand determined the amount of marginal land under cultivation, and that rent was determined by this margin, which had the highest costs of production. Ricardo attacked Smith for putting rent on the same footing with wages and profits as one of the costs of production. He thought that high or low wages and profits were the cause of high or low prices, while high or low rents were the effect of these prices.

Critics of Ricardian theory, such as Henry George, argued that monopolistic control of rent was the cause of poverty, which could only be cured by converting private rights into public by the medium of a "single tax" on land.

Thomas Malthus described the nature of the rent. "The rent of land may be defined to be that portion of the value of the whole produce which remains to the owner of the land, after all the outgoing belonging to its cultivation, of whatever kind, have been paid, including the profits of the capital employed, estimated according to the usual and ordinary rate of the profits of agricultural stock at the time being."[132]

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131 Smith, Adam. The Wealth of the Nations, book 1, chapter XI - Of the Rent of Land, p. 203. Electronic Book Company, London, http://www.elecbook.com/admsmith.zip

132 Malthus, T.R. An Inquiry into the Nature and Progress of Rent, and the Principles by which it is regulated, 1815, p. 5, Electric Book Company, London, http://www.elecbook.com/malrent.zip, quoted by Ricardo, David. An Essay on Profits, 1815. London: Printed for John Murray, Albemarle Street, 1815, McMaster University, Faculty of Social Sciences, http://socserv2.socsci.mcmaster.ca/~econ/ugcm/3ll3/ricardo/profits.txt

Malthus stated that "According to the returns lately made to the Board of Agriculture, the average proportion which rent bears to the value of the whole produce, seems not to exceed one fifth; whereas formerly, when there was less capital employed, and less value produced, the proportion amounted to one fourth, one third, or even two fifths. Still, however, the numerical difference between the price of produce and the expenses of cultivation, increases with the progress of improvement; and though the landlord has a less share of the whole produce, yet this less share, from the very great increase of the produce, yields a larger quantity, and gives him a greater command of corn and labour. If the produce of land be represented by the number six, and the landlord has one fourth of it, his share will be represented by one and a half. If the produce of land be as ten, and the landlord has one fifth of it, his share will be represented by two. In the latter case, therefore, though the proportion of the landlord's share to the whole produce is greatly diminished, his real rent, independently of nominal price, will be increased in the proportion of from three to four. And in general, in all cases of increasing produce, if the landlord's share of this produce do not diminish in the same proportion, which though it often happens during the currency of leases, rarely or never happens on the renewal of them, the real rents of land must rise."[133]

Alfred Marshall defers the nature of the rent from the nature of the wages. "For we are learning that what is commonly called the rent of land is really a very complex thing made up of many elements, some of which differ more widely from one another than it, as a whole, differs from profits, or than some elements of it differ from wages. And as the obverse of this movement, those elements in rent, in profits, and in wages, which are similar to one another, are being drawn together, and the particular laws which govern them are being subsumed under more general laws common to all."[134]

Schumpeter discuses the issue of 'Rent of Land' and quotes Smith: "Rent is partly an interest payment on investments made by the landlord and partly a payment for the 'natural and indestructible powers of the soil'." He argues with the attitude of

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[133] Malthus, T. R., ibid.

[134] Marshall, Alfred. On Rent, Economic Journal vol. 3, 1893, Universite Paris 1, CHPE Centre d'Histoire de la Pensée Economique, http://panoramix.univ-paris1.fr/CHPE/Textes/Marshall/Principles/

Adam smith: "A. Smith's theory of value… 'the rent of land… considered as the price paid for the use of land, is naturally a monopoly price' (Wealth, Book I, ch. II). If this were true, rent would have to 'enter into the composition of the price of commodities' exactly as do profit and wages, which A. Smith explicitly denies on the next page. But of course it is not true: the landed interest is not a single seller and therefore its income cannot be explained by the theory of monopoly." [135]

The various attitudes to the nature of rent are described clearly in those words: "The history of economic thought can be divided into three broad approaches as to the theory of land rent -- the surplus over the cost of production on land theory (1662-1776), the marginal productivity theory (1871-1936), and the intersectoral-net product theory (1960)."[136]

4.5 The Co-influence between Rent and Taxes

Smith describes the co-influence among the height of the rent and taxes and wrote that taxes upon consumable commodities "necessarily raises their price somewhat higher than the amount of the tax, because the dealer, who advances the tax, must generally get it back with a profit. Such a tax must, therefore, occasion a rise in the wages of labour proportionable to this rise of price. It is thus that a tax upon the necessaries of life operates exactly in the same manner as a direct tax upon the wages of labour... His employer, if he is a manufacturer, will charge upon the price of his goods this rise of wages, together with a profit; so that the final payment of the tax, together with this overcharge, will fall upon the consumer. If his employer is a farmer, the final payment, together with a like overcharge, will fall upon the rent of the landlord."[137]

In the feudal regime, the landlords were imposing upon their tenants' tallage, that

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[135] Schumpeter, Joseph. History of economic analysis, George Allen & Unwin Ltd., sixth printing 1967, p. 264.

[136] Land rent, Etwell, John (ed). The New Palgrave a Dictionary of Economics, volume 3, pp. 118-120, the Macmillan Press Limited, London, 1987.

[137] Smith, Adam. The Wealth of the Nations, book 5, chapter II, article IV - Taxes upon Consumable Commodities, pp.1169-1170, Electric Book company, London, http://www.elecbook.com/admsmith.zip

may be considered as a tax or a rent paid for the land they owe.[138]

Thomas Malthus referred to the co-influence among the price of the corn, the height of the rent, and the taxes imposed on the land. "It is a great mistake to suppose that the effects of a fall in the price of corn on cultivation may be fully compensated by a diminution of rents. Rich land which yields a large net rent, may indeed be kept up in its actual state, notwithstanding a fall in the price of its produce: as a diminution of rent may be made entirely to compensate this fall and all the additional expenses that belong to a rich and highly taxed country. But in poor land, the fund of rent will often be found quite insufficient for this purpose. There is a good deal of land in this country of such a quality that the expenses of its cultivation, together with the outgoings of poor rates, tithes and taxes, will not allow the farmer to pay more than a fifth or sixth of the value of the whole produce in the shape of rent."[139]

Henry George,[140] who was a reformer, proposed the "single tax" method: that the state taxes away all economic rent -- the income from the use of the bare land, but not from improvements -- and abolishes all other taxes.

Originally, a tax upon land values proposed as the sole source of government revenues intended to replace all existing taxes. Advocates argued that since land is

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138 “The great nobility, who had consented that the king should tallage the profits of their own tenants, were not unwilling that he should tallage likewise those of an order of men whom it was much less their interest to protect.” ibid. p. 1179

139 Malthus, T. R. The Corn Laws, Observations on the Effects of the Corn Laws, and of a Rise or Fall in the Price of Corn on the Agriculture and General Wealth of the Country, 1814, p.17, Electric Book company, http://www.elecbook.com/malcorn.zip

140 The writer of the book Progress and Poverty. George's book caught the spirit of discontent that had arisen from the great depression of 1873-78. As a basis for his argument, George gave new meaning to the orthodox, or "Ricardian," doctrine of rent. He applied the law of diminishing returns and the concept of "margin of productivity" to land alone. He argued that since economic progress entailed a growing scarcity of land, the idle landowner reaped ever greater returns at the expense of the productive factors of labour and capital. This unearned economic rent, he held, should be taxed away by the state. George envisaged that the government's annual income from this "single tax" would be so large that there would be a surplus for expansion of public works. His economic argument was reinforced and dominated by humanitarian and religious appeal. George Henry, Encyclopaedia Britannica, Britannica.com editors, http://www.britannica.com/eb/article?eu=37207

a fixed resource, the economic rent is a product of the growth of the economy and not of individual effort; therefore, society would be justified in recovering it to support the costs of government. They accepted the view of the economist David Ricardo that a tax on economic rent could not be shifted forward. A second argument was that acceptance of the "single tax" would make other forms of taxes unnecessary, and eliminating taxes on buildings would stimulate construction and economic growth. A third advantage cited was the simplicity of administration of a single tax.

Critics found the tax contrary to the usual standard of ability to pay, since there is no correlation between land ownership and total wealth and income. Moreover, portions of other incomes may be considered just as much "unearned" as land rent. Practically, separation of the value of land and the value of buildings would be very difficult.

While no attempt has been made to use the land tax as a single tax, several jurisdictions have applied their property taxes to land only, instead of to land and buildings, or have taxed land more heavily than buildings. Examples include Australia, New Zealand, the western provinces of Canada, and a few municipalities in the United States.[141]

4.6 The Influence of Growing Population on the Profit from Land

There is a continuous process in value growing of land, and simultaneously the profit of land is growing. These phenomena are unavoidable results of the growing population. More people have to share the same amount of land; therefore, there is less land for each person or family. As the size of land, that can support the dwelling and the livelihood of a family is decreasing, more people dedicate their resources to achieve a smaller size of land. The growth of the population and the modern methods of consuming land enable the continuous process in value growing of land.

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141 Single tax, Encyclopaedia Britannica, Britannica.com editors, http://www.britannica.com/eb/article?eu=69691

I prefer the attitude that is brought in Encyclopaedia Britannica: "Land value reflects its relative scarcity, which in a market economy usually depends on the ratio between the area of usable land and the size of that area's population. As the per capita land area declines, the relative value of land rises, and land becomes increasingly a source of conflict among economic and social groups within the community."[142]

Schumpeter wrote about the growing population problem. "The problem of population, that is to say, the questions what it is that determines the size of human societies and what the consequences are that attend the increase in the number of the country's inhabitants, might well be the first to occur to a perfectly detached observer as soon as he looks at those societies in a spirit of scientific curiosity… The analytic complement of the populationist attitude boils down to one proposition: *under prevailing conditions*, increase in heads would increase real income per head. And this proposition was manifestly correct."[143]

Schumpeter quotes Smith about the growing population problem. "A. Smith summed up by reducing the principle of population to a stale truism, preserving however its character as natural law: 'every species of animals naturally multiplies in proportion to the means of their subsistence, and no species can ever multiply beyond it.' (Wealth, Book I, ch. 8.) And at the same time he declared, in the spirit of the old populationists, that 'the most decisive mark of prosperity of any country is the increase of the number of its inhabitants' (ibid.)."[144]

About one hundred and fifty years earlier to Schumpeter, Ricardo stated an optimistic point of view. "Profits might even increase, because the population increasing, at a more rapid rate than capital, wages might fall; and instead of the value of one hundred quarters of wheat being necessary for the circulating capital, ninety only might be required: in which case, the profits of stock would rise from

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142 Land reform, Introduction, Encyclopaedia Britannica, Britannica.com editors, http://www.britannica.com/eb/article?eu=109594

143 Schumpeter, Joseph. History of economic analysis, George Allen & Unwin Ltd., sixth printing 1967, pp. 250-252.

144 Schumpeter, Joseph. Ibid., pp. 257-258.

fifty to fifty-seven per cent."[145]

4.7 The Forecast of Malthus on the Population Issue

The Malthus[146] Legacy - Two hundred years ago, Thomas Robert Malthus, a British priest, professor of history and economics with a background in mathematics and theology wrote "An Essay on the Principle of Population" (1798).[147] In this essay, he argued that the world population would increase faster than the food supply, with disastrous results for the general human welfare. The Malthus prophecies have been delayed for nearly two centuries by the advancing technologies and the "Green Revolution" which have dramatically increased food production throughout the world. However, these advances appear to have maximized the food production of a finite world while population continues to grow unrestrained. In the following pages I will present opinions regarding Malthus's anticipated population growth and the effect of food limitations on the living standards of an over populated world.

This essay of Malthus is quoted nowadays by many scholars. Jim Fidler calls it: "The deadly legacy of Thomas Malthus".[148] Henry Hazlitt refers to it in his essay "The Conquest of Poverty".[149] Brown, Gardner and Halweil mention it in the "Dimensions of the Population Problem".[150] Donella H. Meadows writes - "200

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145 Ricardo, David. An Essay on Profits 1815, On the Influence, &c. London: Printed for John Murray, Albemarle St., McMaster University, Faculty of Social Sciences, http://socserv2.socsci.mcmaster.ca/~econ/ugcm/3ll3/ricardo/profits.txt

146 See Thomas Malthus homepage at http://www.voyager.co.nz/~malthi/

147 Malthus, T. R. An essay on the Principle of Population, The Electric Book company, London, 1997 (First edition 1789), p 122, http://www.elecbook.com/malpopn.zip

148 Fidler, Jim. The deadly legacy of Thomas Malthus, The myth of overpopulation, The Pages Organisation, http://www.pages.org/bcs/bcs090.html

149 Hazlitt, Henry. The Conquest of Poverty, Chapter 2: Poverty and Population, The Henry Hazlitt Foundation, Originally published by Arlington House, 1973 (New Rochelle, NY). Reprinted by University Press of America, 1986 (Lanham, MD) and by The Foundation for Economic Education (Irvington, NY). http://www.hazlitt.org/e-texts/poverty/ch2.html

150 Brown, Lester R., Gardner, Gary., Halweil, Brian. Beyond Malthus: Sixteen Dimensions of the Population Problem, World Watch Institute, Paper 143, http://www.worldwatch.org/pubs/paper/143.html

Years Since Malthus and We Still Haven't Proved Him Wrong. This year is the 200th anniversary of a small pamphlet that people are still arguing about. In 1798 the Reverend Thomas Robert Malthus said forcefully that the human population tends to grow to the point where it impoverishes itself and starves."[151]

Charles Darwin wrote "In October 1838, that is, fifteen months after I had begun my systematic inquiry, I happened to read for amusement Malthus on *Population*, and being well prepared to appreciate the struggle for existence which everywhere goes on from long- continued observation of the habits of animals and plants, it at once struck me that under these circumstances favorable variations would tend to be preserved, and unfavorable ones to be destroyed. The results of this would be the formation of a new species. Here, then I had at last got a theory by which to work".[152]

Malthus wrote his famous essay on population in order to controvert notions of human perfectibility which were still current in the wake of the French Revolution (1789), and espoused by such writers as William Godwin (1756-1836) and others. Malthus's purpose was to explode such notions based on his view of the inevitable scarcity that would always be a result of human overpopulation.[153]

Peter Landry wrote: "Going against the writings of Godwin and Rousseau Malthus, in his famous work, *An Essay on the Principle of Population*, opined that poverty and distress are unavoidable because population increases faster than the means of subsistence. As checks on population growth, Malthus accepted only war, famine, and disease but later added moral restraint, as well. His theory, at the time of its pronouncement, was most controversial; however, it has not held much currency in the past century, or so; this, because population levels have not come up to the levels expected. The reason, I think, is because of the introduction of inexpensive and readily available birth control procedures; and, of course, because of cultural changes. Malthus, in addition, did not consider the new technology,

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151 Meadows, Donella H. The Global Citizen, the Sustainability Institute, October 8, 1998, http://iisd1.iisd.ca/pcdf/meadows/malthus.html

152 A quotation from Charles. Darwin Autobiography, (1876), http://www.ucmp.berkeley.edu/history/malthus.html

153 The International Society of Malthus, http://www.igc.apc.org/desip/malthus/background.html

which has increased food production and its distribution. Yet, the world population increases."[154]

Niles Eldredge wrote: "Will Malthus Be Right? His forecast was ahead of its time, but nature may still put a lid on humanity… His 'Essay on the Principle of Population,' published in 1798, predicted a gloomy future for humanity: our population would grow until it reached the limits of our food supply, ensuring that poverty and famine would persistently rear their ugly faces to the world. The most casual cruise on the Internet shows how much debate Malthus still stirs today." [155]

Basically, one may say that Malthus was wrong. The population has continued to grow, economies remain robust - and famines in Biafra and Ethiopia are more aberrations than signs of the future. But one may reply that Malthus was right, but technology has postponed the day of reckoning.

But the most interesting and scholar comment was brought by Schumpeter[156] that refers to the second postulate of the *Essay on the Principle of Population.* "That the Population of the world, or, in other words, the number of persons inhabiting it, is limited only by moral or physical evil, or by fear of a deficiency of those articles of wealth which the habits of the individuals of each class of its inhabitants lead them to require."

Schumpeter objects to Malthus's theory. "We have seen already that all the facts and arguments that Malthus presented in the first edition of his *Essay* (1798), down to details of the analysis as well as of the applications, has been worked out before by so large a number of writers that we may speak of them as widely accepted at the beginning of the nineties." Then he says: "The second edition of the *Essay on the Principle of Population* (1803) is a completely new work, which, beside copious statistics, contains an entirely different theory." Thus - interesting phenomenon - the teaching of Malthus *Essay* became firmly entrenched in the

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154 Landry, Peter. Thomas Robert Malthus (1766-1834), http://www.blupete.com/Literature/Biographies/Philosophy/Malthus.htm

155 Eldredge, Niles. Will Malthus Be Right? Visions of the 21st Century, in Time Magazine, http://www.time.com/time/reports/v21/health/malthus_mag.html

156 Schumpeter, Joseph. History of economic analysis, George Allen & Unwin Ltd., sixth printing 1967, pp. 578-581.

system of the economic orthodoxy of the time in spite of the fact that it should have been, and in a sense was, recognized as fundamentally untenable or worthless by 1803 and that further reasons for so considering it were speedily forthcoming.

4.8 Dividing the Profit among the Parties

Profit is the goal of man whether he lives under a feudal regime, a socialistic society, or a capitalistic society. The labourer wants to gain from his work, the loaner expects to gain from his capital, and the landlord hopes to gain from his land. Thus, the philosophical and social issue that was presented in this chapter is the "correct" portion of each party in this total profit.

The different points of view represent the vast economical and social changes that occurred since the industrial revolution. In the 19th century, Europe faced a transfer from a feudal slavery to an urban slavery, which became the ground for the socialistic revolution and the communistic regime.

In the 20th century, we face the rise of the liberal-capitalistic societies, especially after the 2nd World War in Europe and in North America. In those societies the law tries to balance the opposing interests among the labourer, the loaner and the landlord.

Nowadays, the common goal of these three parties is aimed against the heavy taxes imposed by the state and the local municipalities. The landlords are no longer the rulers of the state, and the power to govern is granted to a new social class of "chosen clerks" who's outstanding talent is to come to power and survive as long as possible. This common goal reduces the historical cross-interests among the classical three opponents -- the labourer, the loaner and the landlord.

Chapter 5 Taxation of Real Estate

5.1 Introduction

Taxation of real estate is the main issue in property owning, selling and buying, renting and leasing, marketing and administrating. Taxation of profit of real estate is part of this issue.

The profit derived from land and buildings is considered as a direct and indirect profit, a present profit that is gained on selling or letting land or building, as well as a future profit by owning it. The state and the local authorities participate in this profit by various taxes, duties, levies, and rates. These compulsory payments affect the value of the land, the accessibility to the commerce, the free market of real estate, the prices of products that depend on land i.e., agriculture, industry, commerce, and dwelling, and the life style of the community.

In this dissertation, I will present the arguments among economists and philosophers about the taxation of profit of real estate since the time of the industrial revolution up to now. I will take a glimpse into the ancient world, and will discuss the equilibrium between the needs of the community that impose compulsory payments versus the sacredness of the private property in this era.

Once, such an equilibrium is violated by a greedy ruler, it may cause a crisis in the community and even a military revolution or a mutiny. It happened in Boston,[157] in India[158] and elsewhere. Once a wise ruler achieves such equilibrium, the economy flourishes, as well as the welfare of his people.

Kings and governments consider themselves as "partners" of their citizens, and therefore partners to their income, property, and other commercial or personal activities. Various taxes[159] and duties are imposed in order to "share the wealth" among people, financing the services of the country, the state, and the city, or merely to support the lifestyle of those that their occupation is to rule.[160]

Income tax is imposed on the income. Property tax and capital net tax are imposed on the owners of property. Purchase tax and stamp duty are imposed on purchasing goods and real estate, and selling tax is imposed on selling them. Value additional tax is imposed on the additional value of the production process and on services. Development levies, duties, and rates are imposed on the owner of land for developing the area. Betterment levy is imposed on the increased value of real

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157 The Boston Tea Party (Dec. 16, 1773), incident in which 342 chests of tea belonging to the British East India Company were thrown from ships into Boston Harbor by American patriots disguised as Mohawk Indians. The Americans were protesting both a tax on tea (taxation without representation) and the perceived monopoly of the East India Company.

158 Mohandas Karamchand Gandhi declared a boycott on the British textile, and he encouraged the people of India to spin their own cloth.

159 A "tax" is payment that is imposed by a public authority, (state, local authorities, and others) for which there is no exchange given by the authority to the payer of the tax. The legal definition for "tax" is - "a compulsory payment imposed by a law". The definition of *tax law* - "body of rules under which a public authority has a claim on taxpayers, requiring them to transfer to the authority part of their income or property". "Tax Law", Introduction, Encyclopaedia Britannica, Britannica.com editors, http://www.britannica.com/eb/article?eu=115311 A donation that is given voluntarily by a citizen to a public authority is not a tax. A tax is only that which is imposed. The legal obligation to pay a tax to the state treasury or a local authority is inherently different from the legal obligation to pay, which has been drawn up by contractual agreement. While the obligation for payment by agreement is taken on voluntarily by the person, the obligation to pay taxes is steeped in the law that creates this obligation and imposes it upon the taxpayer. Therefore, tax, levy, fees, duty, custom, excise, toll, tariff, and rate are known as compulsory payments.

160 In 1504 Henry VII levied a feudal aid (tax) to pay for the knighting of his son--who had been knighted 15 years before and had been dead for two. "United Kingdom", Financial policy, Encyclopædia Britannica, Britannica.com editors, http://www.britannica.com/eb/article?eu=120044&tocid=44835#44835.toc

estate and capital gain tax (land appreciation tax) is imposed on the profit from selling the property. War tax and emergency tax are imposed during war and luxury tax is imposed on the luxury lifestyle during peace. Employment tax is imposed on the employer. Duties, tariffs, and customs are imposed on imported goods and fees are imposed on exporting goods. Various rates and fees are imposed on government's services that may not be delivered by the free market due to a law. Entertainment tax is imposed on movies. Capitation tax and poll tax are imposed on the privilege to live under the regime of the ruler. Inheritance tax and estate duties are imposed on the transfer of estate from the deceased to the living and gift tax is imposed on the transfer of estate from the living to the living.[161]

Whether man lives or dies, owns property, buys it or sells it, whether one produces goods, imports or exports them, saving his money or spending it, in health and in sorrow, in war and in peace -- he pays taxes, duties, customs, tributes, levies, fees, excises, tolls, tariffs and rates. The creativity of the ruler takes place by finding new words and names to entitle new compulsory payments, and in democratic regimes to justify it's noble purposes.

5.1.1. Taxes on Property

The ownership of real estate, the various uses of property, and the profit resulting from the sale of property was utilized in history as a good excuse to impose taxes by a ruler on his subjects.

The various taxes imposed on the owners of land and buildings were always the favorite of the rulers because it is difficult to hide the ownership of real estate and any kind of transaction. It is impossible to eliminate land; therefore, it is easy to collect the taxes by selling the land by the tax collector should the taxpayer fail to fulfill his duties.

"While property remains in the possession of the same person, whatever

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161 "Salt is a very ancient and a very universal subject of taxation. It was taxed among the Romans, and it is so at present in, I believe, every part of Europe." Smith, Adam. The Wealth of the Nations, Book 5, chapter II, Article IV - Taxes upon Consumable Commodities, p 1173. The Electric Book company, http://www.elecbook.com/admsmith.zip

permanent taxes may have been imposed upon it, they have never been intended to diminish or take away any part of its capital value, but only some part of the revenue arising from it. But when property changes hands, when it is transmitted either from the dead to the living, or from the living to the living, such taxes have frequently been imposed upon it as necessarily take away some part of its capital value."[162]

Taxation of real estate is one of the reasons whether or not to sell a property, or to exchange it with other property.[163] To analyze this, one should be aware of the various taxes and levies imposed on real estate.

Adam Smith opposed a direct taxation upon the wages of labour, and suggested sharing the burden of taxation between the consumable commodities and the rent of land. Smith advocated that a direct tax upon the wages of labour must, in the long run, cause a greater reduction in the rent of land, and a greater rise in the price of manufactured goods than would have followed from imposing the same amount of taxes partly upon the rent of land, and partly upon consumable commodities.[164]

David Ricardo suggested that the effects of taxation on the necessaries of life tend to diminish capital and production.[165] Various scholars have shown the tendency to

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162 Smith, ibid, Book 5, chapter II, appendix to Articles I and II - Taxes upon the Capital Value of Land, Houses, and Stock, p. 1151.

163 "The financial analysis of whether or not to sell a property should include several components. Tax Considerations. The complex tax code can make it risky to calculate after-tax yields. However, because code provisions allow for tax deferral on exchanges, tax consequences must be considered when comparing hold, sell, or exchange options. An exchange permits the use of pretax dollars as a down payment, but it extracts a penalty in the amount of depreciation that can be taken on the property received in the exchange. A pretax comparison is not merely misleading -- it is patently wrong. If substantial suspended losses exist, they could offset the gain on an outright sale. In this event, investors should be careful not to inadvertently create an exchange." Bierschenk, Letty M., CCIM, Bierschenk, Kurt R., CCIM, Bierschenk, William C., CCIM. Hold, Sell, or Exchange?, in Commercial Investment Real Estate, March/April 2000, http://www.ccim.com/JrnlArt/20000405.htm

164 Smith, Adam. The Wealth of the Nations, book 5, chapter II, Article III - Taxes upon the Wages of Labour, pp. 1159-1164. The Electric Book company, http://www.elecbook.com/admsmith.zip

165 "I by no means agree with Adam Smith, or with Mr Malthus, respecting the effects of taxation on the necessaries of life. The former can find no term too severe by which to characterize them. Mr Malthus is more lenient. They both think that such taxes, incalculably more than any

shift all taxes to land.[166]

Thomas Malthus opposed heavy taxes: "It is, therefore, of great importance, that these prices should be increased as little as possible artificially, that is, by taxation. But every tax, which falls upon agricultural capital, tends to check the application of such capital, to the bringing of fresh land under cultivation, and the improvement of the old. It was shown, in a former part of this inquiry, that before such application of capital could take place, the price of produce, compared with the instruments of production, must rise sufficiently to pay the farmer. But, if the increasing difficulties to be overcome are aggravated by taxation, it is necessary, that before the proposed improvements are undertaken, the price should rise sufficiently, not only to pay the farmer, but also the government. And every tax, which falls on agricultural capital, either prevents a proposed improvement, or causes it to be purchased at a higher price."[167]

In another essay, T. Malthus states: "Every diminution of price not fully and immediately balanced by a proportionate fall in all the necessary expenses of a farm, every tax on the land, every tax on farming stock, every tax on the necessaries of farmers, will tell in the computation; and if, after all these outgoings are allowed for, the price of the produce will not leave a fair remuneration for the capital employed, according to the general rate of profits and a rent at least equal to the rent of the land in its former state, no sufficient motive can exist to

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other, tend to diminish capital and production. I do not say that they are the best of taxes, but they do not, I think, subject us to any of the disadvantages of which Adam Smith speaks in foreign trade: nor do they produce effects very different from other taxes. Adam Smith thought that such taxes fell exclusively on the landholder; Mr Malthus thinks they are divided between the landholder and consumer. It appears to me that they are paid wholly by the consumer." Ricardo, David. An Essay on Profits, 1815, footnote no. 20. London: Printed for John Murray, Albemarle St., McMaster University, Faculty of Social Sciences, http://socserv2.socsci.mcmaster.ca/~econ/ugcm/3ll3/ricardo/profits.txt

166 "Locke, Quency, Adam Smith and others have shown a tendency to shift all taxes to land, whatever the nominal base or event, assuming elastic supplies of labour and capital." Land tax, Etwell, John (ed). The New Palgrave a Dictionary of Economics, volume 3, p. 123, the Macmillan Press Limited, London, 1987.

167 Malthus, T. R. An Inquiry into the Nature and Progress of Rent, and the Principles by which it is regulated, 1815, p. 43, Electric Book Company, http://www.elecbook.com/malrent.zip

undertake the projected improvement."[168]

5.1.2 The Burden of Taxation

Even though taxation in various forms existed since the first man became a ruler or a chief of his fellows, the development of tax laws as a comprehensive general system is a recent phenomenon. One reason for this is that no general system of taxation existed in any country before the middle of the 19th century. In traditional essentially agrarian societies, government revenues were drawn either from non-tax sources such as tribute, income from the royal domains, and rent derived from land or to a lesser extent from taxes on various objects such as land taxes, tolls, customs, and excises.

Levies on income or capital were not considered an ordinary means for financing government. They appeared first as emergency measures. The British system of income taxation, for example, one of the oldest in the world, originated in the act of 1799 as a temporary means for meeting the increasing financial burden of the Napoleon wars.

Another reason for the relatively recent development of tax laws is that the burden of taxation and the problem of definite limits to the taxing power of public authority became substantial only with the broadening in the concept of the proper sphere of government. This approach has accompanied the growing intervention of modern states in economic, social, cultural, and other fields.[169]

The best way to visualize the incidence of a tax is to think of it as a wedge.[170] For example, taxes on cigarettes, liquor, and telephone calls introduce a wedge between the price paid by the buyer and the price that is received by the seller.

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168 Malthus, T. R. The Corn Laws, Observations on the Effects of the Corn Laws, and of a Rise or Fall in the Price of Corn on the Agriculture and General Wealth of the Country, 1814, p.18, Electric Book Company, http://www.elecbook.com/malcorn.zip

169 Tax Law, Introduction, Encyclopædia Britannica, Britannica.com editors, http://www.britannica.com/eb/article?eu=115311

170 Harberger, Arnold C. 'Corporate and Consumption Tax Incidence in an Open Economy', in ACCF (American Council for Capital Formation) Center for Policy Research Special Reports, June 1994, http://www.accf.org/Harberger.htm

Prior to the development of general equilibrium analysis, in which Professor Harberger was a pioneer in the 1960s, economists maintained that part of the corporation income tax was borne by labor, part by consumers, and part by shareholders (or by capital). That led to the thinking that the worst that could happen is that capital would bear the entire tax, Professor Harberger observes. In contrast, general equilibrium analysis leads to the conclusion that capital can bear less, an equal amount, or more than the full burden of the corporate income tax.

5.1.3 The Resistance of the Taxpayers

In 1798, after the American Congress had passed its first direct tax on housing, the government cooked up a scheme to count and measure the windows on every taxpayer's house, in order to calculate how much to charge. But German settlers in eastern Pennsylvania would have none of it. They organized into small bands, armed themselves, and scoured the countryside for assessors who were seized, assaulted, and driven across county lines. When some of the rebels were arrested, an auctioneer named John Fries marched on the courthouse and freed them. President John Adams called out the militia. Fries was arrested, tried for treason, and sentenced to be hanged.

It was hardly the first tax revolt in American history. From the Boston Tea Party to the Whiskey Rebellion to the Fries Rebellion, the late eighteenth century in America was full of armed violence in response to hated taxes. The Fries Rebellion was also far from the last of its kind.

Throughout its history, America has been home to a series of little-known tax rebellions. These rebellions have played major roles in the presidencies of George Washington, John Adams, Thomas Jefferson, and many of their successors. They have helped bring about the Civil war, the birth of the Ku Klux Klan, and, ironically, the birth of the Internal Revenue Service. When the old Internal Revenue Bureau was strengthened to control moonshiner tax rebels in the Appalachia, it started a "Second Whiskey Rebellion" that continues even today.

"We have overthrown the tyranny of British taxes, Federalists' taxes, the Tariff, and the Revenuers' system. Has the tyranny of the Income Tax finally had its day?"[171]

"To cheering crowds, politicians announce plans to dismantle the IRS as we know it and replace it with flat taxes and consumption taxes. But if we burn our 1040 forms, will we really be better off?"[172]

Americans are being literally taxed to death. At work or out shopping, upon marriage or even after death, they are paying more in taxes than ever before. The average family with two wage earners is now seeing almost 40 percent of its money go to local, state, and federal taxes. "The greedy hand of government" first described by American revolutionary Thomas Paine, is greedier than ever, creating a situation ripe for tax reform, if not revolt.

"We think of our forefathers who felt compelled to rebel against the Crown for 'imposing taxes on us without our consent'. We know we live in a democracy, and so must have chosen this arrangement. Yet nowadays we find ourselves feeling that taxes are imposed on us 'without our consent'."[173]

"Long ago, the philosophers who inspired our country's founding and early years anticipated this dilemma. They laid out powerful images that depict the forces affecting our pocketbooks to this day. Adam Smith described the 'invisible hand,' the hand of free commerce that brings magic order and harmony to our lives. Thomas Paine wrote of another hand, all too visible and intrusive: 'the greedy hand of government, thrusting itself into every corner and crevice of industry.' Today, the invisible hand is a very busy one. Markets are wider and freer than ever, and we profit from that by living better than before. But the 'greedy hand of government' is also at work. Indeed, in relative terms, the greedy hand has grown faster than the invisible hand."[174]

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171 Adans, Charles. Those Dirty Rotten Taxes: The Tax Revolts that Built America, in New York: Free Press, 1998.

172 Graetz, Michael J. The Decline (And Fall?) of the Income Tax, In New York: W.W. Norton & Company, 1997.

173 Shlaes, Amity. The Greedy Hand: How Taxes Drive Americans Crazy and What to Do About It, Random House, 1999. http://www.booknotes.org/chapter/fc041199.htm

174 Ibid. Chapter 1.

5.2 History of Taxation[175]

5.2.1 Administration of Taxation

Patterns of taxation throughout history can be explained largely by administrative considerations. Because it is easier to tax imports than to tax domestic output, import duties were among the earliest taxes. Similarly, the simple "turnover tax", levied on gross sales, long held precedence over the conceptually preferable "value-added tax", which allows credit for tax paid on purchases. As for personal taxes, it is easier to identify real property than other assets, and a "head tax" is even easier to implement. It is not surprising, therefore, that the first direct levies were head and land taxes.

Taxes played a relatively minor role in the ancient world. Taxes on consumption were levied in Greece and Rome. Tariffs, taxes on imported goods, were often of considerably more importance than internal excises so far as the production of revenue went. As a means of raising additional funds in time of war, taxes on property would be temporarily imposed. For a long time, these taxes were confined to real property, but later they were extended to other assets. Real estate transactions also were taxed. In Greece, free citizens had different tax obligations from slaves. In Rome the tax laws distinguished between the Roman citizens from the residents of the conquered territories.

In Rome, along with consumption taxes and customs duties, there were certain direct taxes. The principal of these was the "tributun" paid by citizens and usually levied as a head-tax. Later, when additional revenue was required, the base of this tax was extended to real estate holdings. In the time of Julius Caesar a 1% general sales tax was introduced. The provinces relied for their revenues on head tax and land tax. The land tax consisted initially of fixed liabilities regardless of the return from the land, as in Persia and Egypt. Later, the land tax was modified to achieve a certain correspondence with the fertility of the land, or, alternatively, a 10% of the produce was collected as a tax in kind (the "tithe"). It is noteworthy that at a relatively early time Rome had an inheritance tax of 5%, later 10%. However,

175 Taxation, History of Taxation, Encyclopædia Britannica, Britannica.com editors, http://www.britannica.com/eb/article?eu=115309&tocid=72007#72007.toc

close relatives of the deceased were exempted.

For a long time the tax collection was left to middlemen or tax-farmers, who contracted to collect the taxes for a share of the proceeds. Under Caesar, collection of taxes was delegated to civil servants.

In the Middle Ages many of these ancient taxes, especially among the direct levies, vanished and gave way to a variety of obligatory services.

The main indirect taxes were transit-duties and market-fees. In the cities, the concept developed of a tax obligation encompassing all residents. The burden of taxes on certain foods and beverages was intended to be borne partly by consumers and partly by producers and tradesmen.

During the latter part of the Middle Ages, some German and Italian cities introduced several direct taxes: head-taxes for the poor and net-worth taxes or occasionally crude-income taxes for the rich. The income tax was administered through self-assessment and an oath taken before a civic commission. The use of land taxes and taxes on houses gradually spread.

Taxes have been a major subject of political controversy throughout history, even before they constituted a sizable share of the national income. A famous instance is the rebellion of the American colonies against Great Britain when the colonials refused to pay taxes imposed by a Parliament in which they had no voice; hence, the slogan, "no taxation without representation." Another instance, is the French Revolution of 1789, in which the inequitable distribution of the tax burden was a major factor.

Wars have influenced taxes much more than taxes have influenced revolutions.[176] Many taxes, notably the income tax (first introduced in England in 1799) and the turnover tax (Germany, 1918) or purchase tax (Great Britain, 1940) began as temporary war measures. Similarly, the withholding method of income tax collection began as a wartime innovation in France, the United States, and Britain. World War II converted the income taxes of many nations from upper-class taxes

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176 "Let them march all they want so long as they continue to pay their taxes." General Alexander Haig.

to mass taxes.[177]

It is hardly necessary to mention the role that tax questions play in peacetime politics, where the influence of powerful, well-organized pressure groups is great. Arguments for tax reform, particularly in the area of income taxes, are perennially at issue in the domestic politics of many countries.

War Tax Resistance in U.S.A. is a movement of peace activists who refuse to pay all or a portion of their income tax, or who make a conscious decision to live simply and reduce their income to below-taxable level. The War Tax Resistance movement claims that war taxes comprise that portion of income tax directly contributed to military and weaponry in the Federal Budget.

5.2.2 Modern Trends

The development of taxation in recent times can be summarized by the following general statements: The authority of the sovereign to levy taxes in a more or less arbitrary fashion has been lost, and the power to tax now generally resides in parliamentary bodies.

The level of most taxes has risen substantially and so has the ratio of tax revenues to the national income. Taxes today are collected in money, not in goods. Tax farming has been abolished; taxes are assessed and collected by civil servants. There has been a reduction in reliance on customs duties and excises. Many countries increasingly rely on sales taxes and other general consumption taxes.

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177 "Nation-states in the modern world, - regardless of professed ideology - consistently work to maintain and expand their own power. No country does this more consistently, more ruthlessly, and more successfully than the United States. Over half of U.S. tax dollars go to military spending. Not to housing, education, environmental protection, or any of the other desperately needed social programs, but to killing people to maintain state and corporate power, expand wealth, and enforce racism, sexism, homophobia and xenophobia. The U.S. military does not, as it claims, protect us from people who would take what is rightfully ours; instead it protects them, the people who take what is rightfully ours, from us. One of the best ways to challenge that power is to refuse to fund the system that maintains it. Consider, and encourage your friends to consider, refusing to pay taxes for war and military spending - and redirecting refused tax money to positive uses." War Tax Resistance and Anarchism, in National War Tax Resistance Coordinating Committee, http://www.nwtrcc.org/issues.htm

An important late 20^{th} century development has been the replacement of turnover taxes with value-added taxes. Taxes on the privilege of doing business and on real property have lost ground and are important today mainly as revenue sources for local communities. The absolute and relative weight of direct personal taxation has been growing in most of the developed countries, and increasing attention has been focused on payroll taxes and value-added taxes.

Income taxes, both of individuals and of corporations, payroll taxes, general-sales taxes, and in some countries property taxes occupy leading positions in modern tax systems. The income tax has ceased to be a rich man's tax. The general populace now pays it, and in several countries it is complemented by the net-worth tax.

The emphasis on the ability-to-pay principle and on the redistribution of wealth, which led to graduated rates, especially in the case of income taxes, appears to have peaked and been replaced by greater concern for the economic distortions and disincentives caused by high tax rates. A good deal of fiscal centralization has occurred, as reflected in the kinds of taxes levied by central governments. The latter, now control the most important taxes from a revenue-producing point of view: income taxes and corporation taxes, payroll taxes, and value-added taxes. Various ways have been found to allow lower-level governments and local authorities to share in the tax revenues of central governments.

Developed countries usually rely more heavily on individual income taxes than do developing countries but less heavily on corporation income taxes. Among developing countries, reliance on income taxes, especially on corporate income taxes, generally increases as the level of income rises. The poorest countries rely more heavily on taxes partly because they lack the administrative capacity to implement more sophisticate taxes on income. A relatively high percentage of the total tax revenue of industrialized nations comes from domestic consumption taxes, especially the value-added tax rather than the simpler turnover tax. Social security taxes, commonly payroll taxes, are much more important in developed countries and the more affluent developing countries than in the poorest countries, reflecting the near lack of social security systems in the latter countries.

Taxes in general represent a much higher percentage of national output in developed countries than in developing countries. In many respects the tax systems of the developing countries with the highest levels of income resemble those of developed countries more than those of the poorest developing countries.

5.3 The Philosophy of Taxation

5.3.1 The Essence of Tax

A "Tax" is a payment that is imposed by a public authority, for which there is no direct monetary exchange given by the authority to the payer of the tax. Public authorities are the state and local authorities. A tax is only that which is imposed. A donation that is given voluntarily by a citizen to a public authority is not a tax. The legal obligation to pay a tax to the state treasury or a local authority is inherently different from the legal obligation to pay, which has been drawn up by contractual agreement. While the obligation for payment by contractual agreement is taken on voluntarily by the person, the obligation to pay taxes is steeped in the law that creates this obligation and imposes it upon the taxpayer. Therefore, taxes, levies, fees, duties, customs and rates are known as "obligatory payments".[178]

Tax is intended to finance the general activities of the public authorities, and the taxpayer is entitled to a service in return for the taxes he has paid. However, the exchange is not meant to stand in direct relation to the amount of tax that said taxpayer has paid. Hence, for example, citizen "A" earns a large income and pays a large sum in income tax, and citizen "B" earns a small salary and pays no income tax at all - but both are entitled to the same services given by the state. Citizen "C" pays a considerable amount of property tax for quite a few expensive properties in his possession, but is not eligible, in exchange for this significant sum, for any special services that citizen "D" is not entitled to, even though citizen "D" pays no property tax at all. Citizen "E" pays VAT for the purchase of an expensive home and citizen "F" pays a small amount of VAT for the purchase of an inexpensive apartment or no VAT at all if he does not purchase an apartment, but both are entitled to the same government services.

Compulsory payments which are imposed by legal statute include taxes but do not

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[178] The legal definition for tax is a compulsory payment imposed by a law.

entitle the taxpayer to any exchange in direct relation to the sums imposed upon him, including those assorted fees imposed for the purpose of carrying out specific and defined activities. The government authorities impose specific compulsory payments, called fees, in exchange for which the subject is entitled to a service that is directly relative to the fee which he has paid.

Fees are a combination of tax and price. Tax, because the fee is imposed legally and not according to any agreement and the rate is not susceptible to negotiation. Price, because the rate of the fee is meant to be a reasonable exchange for he who pays it, and the provision of a service or other product is directly proportional to the services or other products provided.

"Taxation is the form of socialization used in market economies. Choosing what to tax is choosing what to socialize. Rather than socialize labour or repel capital it is possible to tax land… The entire value of land, now and forever, is here regarded as benefit received from government. This is consistent with Alfred Marshall's concept, 'the public value of land', where value is the product of three things: nature; government; and spillover values from development of adjoining and linked lands. All these values, being unearned by the individual landholder, are fit to be taxed… Land taxes are *in rem*… Avoiding land taxes is next to impossible, even though collection enforcement is limited to seizing the land, not the person or any other asset."[179]

Tax law is concerned only with the legal aspects of taxation, not with its financial, economic, or other aspects. The making of decisions as to the merits of various kinds of taxes, the general level of taxation, and the rates of specific taxes, for example, does not fall into the domain of tax law; it is a political, not a legal, process.[180]

"The reason why the consumer pays a tax upon any manufactured commodity, or an advance in the price of any of its component parts, is because, if he cannot or will not pay this advance of price, the commodity will not be supplied in the same

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179 Land tax, Etwell, John (ed). The New Palgrave a Dictionary of Economics, volume 3, p. 122, the Macmillan Press Limited, London, 1987.

180 Tax Law, Introduction, Encyclopædia Britannica, Britannica.com editors, http://www.britannica.com/eb/article?eu=115311&tocid=0

quantity as before; and the next year there will only be such a proportion in the market, as is accommodated to the number of persons who will consent to pay the tax."[181]

5.3.2 Tax Epistemology

Real estate is an asset which is not only considered to be "consumer goods" in all levels of the population, but is also a preferred objective for many investors. Real estate can be marketed by means of tax shelters incentives. The significance here is the sophisticated consumer who will buy property by these means will not have to share the resulting profit with the government. Thus, a tax shelter is one of the more important factors to be considered by the potential consumer when the time comes to invest. When the consumer is ready and able to purchase "consumer goods" which can take advantage of this tax shelter, the advantage is that he alone will enjoy the fruits of the property that he has purchased.

This dissertation presents and analyzes two tax shelters that enable the consumer to enjoy the profits of sale with significant tax benefits.

The sophisticated investor who has taken advantage of knowledgeable legal advice at his disposal knows that the purchase of real estate that turned a profit at time of sale is exempt from taxes. The public or the middle classes that invest their money and pay their taxes at which time their property has turned a profit do not generally know this information. Marketing real estate by means of this tax shelter incentive is targeted mainly at this large section of the population. The assumption is, of course, that a person who is looking to invest his capital in property will prefer to do this by methods that will enable him to enjoy the resulting profits without involving the state treasury.

5.3.3 Purposes of Taxation

In modern economies, taxes are the most important source of governmental

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[181] Malthus, T. R. The Corn Laws, Observations on the Effects of the Corn Laws, and of a Rise or Fall in the Price of Corn on the Agriculture and General Wealth of the Country, 1814, p. 8, Electric Book Company, http://www.elecbook.com/malcorn.zip

revenue. Taxes differ from other sources of revenue in that they are compulsory payments and are unrequited. While taxes are presumably collected for the sake of the welfare of taxpayers as a whole, the liability of the individual taxpayer is independent of any benefit received. There are important exceptions to this characterization. Payroll taxes are commonly levied on labour income in order to finance retirement benefits, medical payments, and other social security programs. Because there may be some link between taxes paid and benefits received, payroll taxes are sometimes called "contributions". Nevertheless, the payments are commonly compulsory and the link to benefits is usually quite weak.

During the 19th century, the prevalent idea was that taxes should serve mainly to finance the government. In earlier times, and again today, governments have utilized taxation for other than merely fiscal purposes. One useful way to view the purpose of taxation is to distinguish between objectives of resource allocation, income redistribution, and economic stability.

The re-distributive objective is to lessen inequalities in the distribution of income and wealth to the extent they are considered excessive and unjust. The stabilization objective, which tax policy shares with government expenditure policy under the rubric of fiscal policy and monetary policy, is the maintenance of high employment and price stability.

Tax is an instrument to share the wealth among people.[182] According to this concept, members of the community that earn more, spend more, possessing more, and dying richer, should pay more taxes than the members of the community that earn less, spend less, possessing less, and dying poorer. This ideology is obviously embraced by the poor and middle classes and therefore by politicians in democratic countries that needs the votes of the majority. The opposers point, that this attitude does not encourage people to work harder and to contribute more to the society that supports them.

Tax is an instrument to finance the services of the state, i.e. army, foreign office, and welfare, in spite of that most of the taxpayers would rather give up those

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[182] Dunkiel, Brian M. Hamond, Jeff. Motavalli, Jim. Sharing the Wealth, If We Shift the Tax Burden From Work to Waste, Everyone Benefits, in E-magazine, http://www.emagazine.com/march-april_1999/0399feat1.html

services. And finally, tax is an instrument to finance the lifestyle of the chosen ones and their civil servants that assist them to stay in power.

Tax may be an instrument to achieve environmental goals. The industrial revolution and the growing population caused a massive usage of land with characterized by environmental damages. If the plant makes $1,000 worth of its product at a cost of $2,000 in environmental damage, it nets $1,000, meaning the pollution's victims are subsidizing the polluter. Even more perversely, a conscientious factory owner who wanted to buy equipment to cut the pollution couldn't, since the cost would put him at an economic disadvantage to his competitors. It's a bizarre, unfair situation. British economist Arthur Cecil Pigou recognized this inequality in the 1920's and advocated environmental taxes that would make polluters pay the real costs of their activities. He's as right today as 80 years ago.[183]

5.3.4 Economic Goals

The primary goal of a national tax system is to generate revenues to pay the expenditures of government at all levels. Because public expenditures tend to grow at least as fast as the national product, taxes, as the main vehicle of government finance, should produce revenues that grow correspondingly. Income, sales, and value-added taxes generally meet this criterion; property taxes and taxes on nonessential articles of mass consumption such as tobacco products and alcoholic beverages do not.

Tax policies can promote economic growth. In order to obtain it, the state should avoid measures preventing growth and emphasize measures stimulating it. This approach may imply a qualitative restructuring of the tax system or special tax advantages to stimulate saving, labour mobility, research and development, etc. It implies the need to avoid high marginal tax rates and the tax-induced diversion of resources into relatively unproductive activities.

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[183] Pigou, Arthur C. 'Wealth and Welfare', 1912, London: Macmillan, quoted in 'Greening the Tax Man' in The progress report, http://www.progress.org/archive/shift03.htm

5.3.5 Shifting and Incidence

The incidence of a tax rests on the person whose real net income is reduced by the tax. It is fundamental that the real burden of taxation does not necessarily rest upon the person who is legally responsible for payment of the tax.[184]

Business firms pay sales taxes but most of the burden is assumed to rest upon those who buy the goods that are taxed. In other words, the tax is shifted from the business to the consumer.

Taxes may be shifted in several directions. Forward shifting takes place if the burden falls entirely on the user, rather than the supplier of the commodity or services in question e.g., if an excise tax on luxuries increases their price to the purchaser. Backward shifting occurs when the price of the article taxed remains the same and the cost of the tax is borne by those engaged in producing it e.g., through lower wages and salaries, lower prices for raw materials or a lower return on borrowed capital. Finally, a tax may not be shifted at all; for example, a tax on business profits may reduce the net income of the owner of the business.

Tax capitalization occurs if the burden of the tax is incorporated in the value of long-term assets e.g., if the price of land declines by an amount that offsets an increase in property taxes. In this case, the present owner of the land takes a capital loss when he sells the asset. Its price will be lower by the capitalized value of the tax.

The direction and extent of tax shifting is determined basically by one principle. The user of a tax object can avoid the tax burden to a greater or lesser extent the easier or the more difficult it is for him to find non-taxed or less-taxed alternatives or substitutes for the tax object. The supplier of a production factor that is taxed itself can avoid the tax burden to a greater or lesser extent the easier or the more difficult it is for him to find equivalent non-taxed or less taxed alternative employment opportunities for this factor.

Because the demand for substitute goods will increase, their prices may rise, thus benefiting the producers of such goods and placing part of the tax burden on those

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[184] Shifting Gears: Rethinking Property Tax Shift Relief, Legislative Analyst's Office, February 2, 1999, http://www.lao.ca.gov/020299_property_tax_shift.html

individuals who used them before the tax was imposed. Likewise, the productive factors that seek alternative employment's to avoid the tax will tend to receive lower returns in those employment, thus placing part of the burden on individuals who supplied the factors in those sectors before the tax was imposed.

For example, if wine is taxed while beer is not, these two beverages are regarded as perfect substitutes, and the price of beer does not rise with increased demand, the tax burden will fall on the owners of land used for viticulture and on the workers engaged in it. It will fall mainly on the landowners if the soil is specific to wine growing and if labour has alternative employment possibilities. If, on the other hand, wine drinkers are determined to drink only wine, they will bear most of the tax burden. If some substitution of beer for wine takes place, the price of beer rises somewhat, both, wine and beer drinkers will bear the burden, and owners of resources specialized to the production of beer will benefit.

The extent of shifting may vary over time, depending on how long it takes to adjust consumption patterns, reallocate land and capital, and re-train labour. Those users and suppliers who have the most difficulty in adjusting will bear the largest burden.

The kind of tax that is imposed affects tax shifting. The broader/narrower the tax bases, the higher/lower his tax burden, since the range of non-taxed or less-taxed substitutes at his command is narrower/wider. Thus, an excise tax on only a few alcoholic beverages allows partial shifting through a change in the consumption pattern, while a tax on all such beverages does not.

The smaller the jurisdictional unit imposing the tax, the easier it tends to be for a user to obtain non-taxed or less-taxed substitutes from outside the jurisdiction and for a supplier to find non-taxed or less-taxed outside employment opportunities for his goods and services. Thus, a medium-size city that imposes a high property tax that is likely to be borne by suppliers of commodities. This is particularly relevant to the determination of the incidence of city property taxes that are often to be exported out of city by moving the industry or shopping centers to other cities. In small communities, the only really immobile factors are likely to be real estate, certain local services, and poor families.

5.3.6 Classes of Taxes

Taxes are most commonly classified as either direct or indirect, an example of the former type being the income tax and of the latter the sales tax. It is usually said that a direct tax is one that cannot be shifted by the taxpayer to someone else.

Direct taxes - direct taxes are primarily taxes on persons; they are aimed at the individual's ability to pay as measured by his income or his net wealth. The main types of direct taxes are the following.

Individual income taxes are commonly levied on total personal net income in excess of some stipulated minimum. They are also commonly adjusted to take into account the circumstances influencing the ability to pay of the individual, such as family status, number and age of children, and financial burdens resulting from illness. They are often levied at graduated rates, that is, at rates that rise as income rises.

Taxes on net worth are levied on the total net worth of a person, that is the value of his assets minus his liabilities. As with the income tax, the personal circumstances of the individual can be taken into consideration.

Taxes at death take two forms: the "inheritance tax", where the tax object is the bequest received by the person inheriting, and the "estate tax", where the object is the total estate left by the deceased. Inheritance taxes usually allow for the personal circumstances of the taxpayer, including his net worth before receiving the bequest and his relation to the donor. Estate taxes are generally graduated according to the size of the estate, and in some countries they make allowance for the number of children involved.[185] In order to prevent the death duties from being circumvented, any rational and efficient tax system has to include a "gifts tax" between living persons, particularly those deemed to be made in anticipation of death.

"Spending taxes", are taxes on all income that is not channeled into savings. In contrast to indirect taxes on spending, such as the "sales tax", an expenditure tax can be adjusted to an individual's ability to pay by allowing for marital status, age,

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185 Saxton, Jim. The Economics of the Estate Tax, in Join Economic Committee Study, U.S. House of Representatives, http://www.house.gov/jec/fiscal/tx-grwth/estattax/estattax.htm

number of dependents, etc.

Indirect taxes - Indirect taxes are levied on objects and services or transactions. They include general and selective taxes on sales of consumer goods, value-added taxes, taxes on goods in the process of production, taxes on legal transactions, and import or customs duties.

"Sales taxes" are levies that burden a substantial portion of consumer expenditures. The same tax rate can be applied to all taxed items, or different items can be subject to different rates. Single-stage taxes can be collected at the retail level, or they can be collected at a pre-retail (manufacturing or wholesale) level. Multistage taxes are applied at each stage in the production-distribution process. Value-added taxes, one of the most important fiscal innovations of the second half of the 20th century, are commonly collected by allowing the taxpayer to deduct a credit for tax paid on purchases from liability on sales. Such taxes have largely replaced turnover taxes, a defective form of tax in which tax was collected at each stage, with no relief for tax paid at previous stages.

Taxes on specific commodities are called excises, as distinguished from sales taxes and other general consumption levies. Generally applicable sales taxes sometimes exempt necessities in an effort to reduce the burden on low-income households. Excises and customs duties are levied on almost everything, from necessities such as bread, meat, and salt, to nonessentials such as cigarettes, wine, liquor, coffee and tea, to luxuries such as jewels and furs.

Some excises and custom duties are specific i.e. they are levied on the basis of weight, length, volume, and other specific characteristics of the tax object. Other taxes are ad valorem, levied on the value of the goods as measured by the price.

Taxes on consumer durables formerly were applied to luxury commodities such as pianos, saddle horses, carriages, and billiard tables. Today the main tax object is the automobile, largely because registration requirements facilitate administration of the tax.

Taxes on intermediate goods and production factors are levied on raw materials, intermediate goods, machines, or labour.

Taxes on legal transactions are levied on the issue of shares, on the sale of houses and land, and on stock exchange transactions. For administrative reasons, they are frequently levied in the form of stamp duties, that is, the legal or commercial document is stamped to denote payment of the tax.

Proportional, progressive, and regressive taxes - Taxes can also be distinguished on the basis of the effect they have on the distribution of income and wealth. A proportional tax is one that imposes the same relative burden on all taxpayers i.e., where tax liability and income grow in equal proportion. A "progressive tax" is characterized by a more than proportional rise in the tax liability relative to the increase in income, and a "regressive tax" is characterized by a less than proportional rise in the relative burden.[186] Thus, progressive taxes reduce the inequality of income distribution and regressive taxes increase it.

Examples of taxes that are generally considered progressive are income taxes and death duties. Income taxes that are nominally progressive may become less so in the upper income categories. On the other hand, in the lower income categories to which a proportional tax rate applies, some progression is introduced through the personal exemptions.

Sales taxes and excises tend to be regressive, even though they may be nominally proportional, because the share of personal income spent on a specific good decline as the level of personal income rises. Poll taxes, levied as a fixed amount per capita, obviously are regressive.

Because of uncertainty about the shifting of corporate income taxes and property taxes, it is difficult to know whether such taxes are progressive, regressive, or proportionate. This uncertainty is confounded by the fact that determining on whom the burden of such a tax falls depends on whether a national or a state tax is being considered.

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[186] "The solution is to make the regressive taxes pinch landowners. The income tax, when new, was designed to do exactly that. Georgists like Congressman Henry George, Jr. and Warren Worth Bailey took the lead in shaping it to do so. Over time, though, it has changed into mainly a payroll tax, and as it changed it became increasingly popular with landowners. It served their greed and became the clarion call of their constant clamor for 'property tax relief'." Gaffney, Mason. Property Tax Reform Priorities, part 9, Priority #5: Make Landowners Pay Their Taxes, in The Progress Report, http://www.progress.org/archive/gaffne09.htm

5.4 Principles of Taxation

The 18th-century philosopher Adam Smith attempted to systematize the rules that should govern a rational system of taxation, and he set down four general canons:[187]

I. The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the state…

II. The tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor and to every other person…

III. Every tax ought to be levied at the time, or in the manner, in which it is most likely to be convenient for the contributor to pay it…

IV. Every tax ought to be so contrived as both to take out and keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the state…

Although they need to be reinterpreted from time to time, these principles especially the first and last, retain remarkable relevance. From the first can be derived both of the leading views of what is fair in the distribution of tax burdens among taxpayers. These are the belief that taxes should be based on the individual's ability to pay, known as the ability-to-pay principle, and the benefit principle, the idea that there should be some equivalence between what the individual pays and the benefits he derives from governmental activities.

The fourth of Smith's canons can be interpreted to underlie the emphasis many economists place on a tax system that does not interfere with market decision making, as well as the more obvious need to avoid complexity and corruption.

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[187] Smith, Adam. The Wealth of the Nations, book 5, Chapter II, part II - of taxes, pp. 1103-1106. The Electric Book company, http://www.elecbook.com/admsmith.zip

5.4.1 Distribution of Tax Burdens

The principle of horizontal equity requires that people in the same or similar positions so far as tax purposes are concerned will be subject to the same tax liability. In practice, this equality principle is often disregarded, both intentionally and unintentionally.

Intentional violations are usually motivated more by politics than by sound economic policy *e.g.,* the tax advantages granted to farmers, homeowners, or members of the middle class in general; the exclusion of interest on government securities. Much of recent debate over tax reform has centered on whether deviations from "equal treatment of equals" are justified.

5.4.2 The Ability-to-Pay Principle

The ability-to-pay principle requires that the total tax burden be distributed among individuals according to their capacity to bear it, taking into account all of the relevant personal characteristics in such a way that the relative loss in economic capacity resulting from the tax is equal.[188]

The primary indicator of ability to pay is commonly agreed to be income. Some theorists include wealth in the ability-to-pay criterion. Indirect taxes such as excise, sales, turnover, or value-added taxes can be adapted to the ability-to-pay criterion only to a limited extent, for example, by the taxation of services, the exemption of necessities, or the differentiation of tax rates according to "urgency of need."

The argument is that because of differences in talent and other accidents of birth and because of various restrictions and monopoly elements, the market mechanism does not necessarily distribute income and wealth according to effort and merit. Moreover, poverty may result from some work disability or from an unfavorable social or family background. The latest view is that taxes should not be used for re-distributive purposes, because of the disincentives and distortions that high tax rates create.

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188 See on this topic: Tax Equity: Benefit and Ability to Pay Principles, The World Bank Group, http://www1.worldbank.org/publicsector/tax/tax_equity.htm

5.4.3 The Benefit Principle

Under the benefit-principle, taxes are seen as serving a purpose similar to that of prices in private transactions. That is, they help determine what activities the government undertakes as well as who pays for them.

If this principle could be implemented, resource allocation would be directly responsive to the wishes of citizens as consumers of public services, not just as voters. To the extent that the demand for public services does not rise in proportion to income, benefit-related taxes would be regressive.

In fact, it is difficult to implement the benefit principle for most public services because citizens generally have no incentive to pay the tax and reveal their preferences for publicly provided activities, unless they can be excluded from enjoying the benefits of the service if they fail to pay.

The benefit principle is utilized primarily in the financing of roads and highways through levies on motor fuels and road user fees. Payroll taxes used to finance social security may also reflect a link between benefits and "contributions," but this link is commonly weak.

5.5 The Influence of Tax Rates on the Land Value

An income tax imposed on the rent of land is a direct instrument to share the income between the landlord and the state treasury. A property tax imposed on the ownership of land is an indirect instrument to share the potential income between the landlord and the state Treasury or the exchequer of the local authorities.

As long as the rates of those taxes are reasonable, one may consider them as a payment to the state in exchange to the protection they supply him by the legal system (courts and police force) to enjoy the benefits of his property. This kind of relationship may be described also as a "partnership" between the landlord and the government, in which the landlord takes the direct care of the real estate and its fruits, and the government, the "silent partner", is responsible to maintain a system that supports this practice.

If the rates of those taxes are not reasonable, and the "silent partner" is claiming too big a portion of the benefits, it may be considered as a continuing process of confiscating the equity of the owner. While confiscation of land is a compulsory selling and the confiscator should pay for the property, in the continuing process of confiscation the owner gets no payments. Actually, high rates of taxation reduce the value of land, because the landlord gains a small portion of its benefits.

Tax capitalization occurs when the burden of the tax is incorporated in the value of long-term assets e.g., if the price of land declines by an amount that offsets an increase in property taxes. Capitalization can result where there is forward shifting, backward shifting, or no shifting e.g., an increase in the price of gasoline resulting from higher motor fuel taxes may reduce the value of high-consumption automobiles. In such cases, the present owner of the asset takes a capital loss since, when he sells the asset, its price will be lower by the capitalized value of the tax.

Early empirical studies based on the traditional view found the property tax to be regressive in its pattern of incidence. Treating the tax burden on housing as proportional to annual housing expenditure and consumption as a proportion of measured annual income fall with the level of income, the property tax must be regressive. Later studies, however, employing a permanent-income concept and other improvements in measurement procedures, cast serious doubt on the regressing of the tax.[189]

5.6 The Structure of the Tax Law

All tax laws and other compulsory payment laws has a similar legal structure, because they have the same purposes - to impose a compulsory payment upon the tax payer and collecting money to the state Treasury or to the exchequer of the local authorities.

It has no significance which legal system imposed the tax. It has no significance if it is a law that was legislated in the year 2001, in Rome or among an ancient primitive society - in all these laws one can find the same legal structure that is the result of the same purpose those laws try to achieve.

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189 Property Taxation, Etwell, John (ed). The New Palgrave a Dictionary of Economics, volume 3, p. 1034, the Macmillan Press Limited, London, 1987.

I have found in tax laws 12 basic fundaments. Sometimes, a tax law contains all of them and sometimes most of them -

A. **The authority** - the state, local municipality or other authority that is entitled to impose the tax.
B. **The tax-subject** - the taxpayer.
C. **The tax-object** - the object that is the cause to impose the tax upon the taxpayer.
D. **The tax event** - the event that creates the abstract obligation of the taxpayer.
E. **The payment day** - the date when the abstract obligation of the taxpayer becomes a debt, which the tax collector is entitled to collect the tax.
F. **The tax rates** - the sums, the percentages, and the rates of the tax.
G. **Exempts and reductions** - the terms to reduce the sum of the tax or to exempt the taxpayer of paying it.
H. **Declaration and self-assessment** - the duty of the tax payer to declare upon various details regarding the relevant data i.e. his name, tax-object, tax event, tax rates, exempts and reductions etc. In some tax laws his duty to prepare a self-assessment and to submit it to the tax officer.
J. **Tax assessment** - the duty of the tax officer to prepare the tax assessment, and to submit it to the taxpayer.
I. **Appeal** - the rights of the taxpayer to object the tax assessment, and the ways to implement the objection.
K. **Tax enforcement** - the legal ways by which the tax collector is entitled to collect the tax debts should the taxpayer fail to pay it after the payment day.
L. **Interest, fines and penalties** - the interest the fines and the penalties imposed on the taxpayer if he fails to fulfil his duties i.e. declaration, self-assessment and paying the tax on the due date.

5.6.1 The Authority

Any tax law defines which authority is entitled to impose the tax. Usually, the tax authority is the government, but it may be as well the state or canton governor, a local municipality, a planning committee, the social security bureau, or any other authority that is entitled by the law to impose the compulsory payments.

5.6.2 The Taxpayer

The subject of the tax is the taxpayer. The tax is imposed on the taxpayer and he is obliged to pay it. Most of the tax laws are not using the exact formulation and they say that the tax is imposed on the object, i.e. the income tax is imposed on the income, the property tax is imposed on the property etc.

A tax law should define punctually who are the taxpayers that should carry the burden. The tax officer that prepares the assessment is obliged to certify that the assessment the notification is issued to the correct name of the taxpayer including his identification number.

A taxpayer should be a legal entity - human or corporation. One cannot impose tax upon a commercial name i.e. Coca-Cola for the simple reason that nobody will pay it, therefore, an assessment that is issued to Abraham the shoemaker is invalid. An authority that is issued to a wrong name may lose the tax. The result is that the subject of the income tax is the one who had income, the subject of the property tax is the owner of the land, and the subject of the V.A.T is the one who sells goods or services.

5.6.3 The Tax Object

The tax-object is the object that is the cause to impose the tax upon the taxpayer. The tax is not imposed on the object because an object has no legal entity. The income is the cause to impose income tax, selling goods or submitting services is the cause to impose V.A.T., owning property is the cause to impose property tax, buying or using luxury products or services is the cause to impose luxury tax, and death is the cause to impose inheritance tax.

5.6.4 The Tax Event

The tax event is an action that is performed by the taxpayer or by other, or timing specified by the tax law. The tax event creates the abstract obligation of the taxpayer. At the moment of the tax event, the debt of the taxpayer is not yet crystallized because no tax assessment has been prepared at this time.

The timing of the income is the tax event of income tax. At that time, the obligation of the taxpayer to pay income tax is abstract because the fiscal year was not ended and the income is calculated on the income of the whole year.

The tax event of the capital gain tax (land appreciation tax), the purchase tax, and the selling tax happens at the day that the parties sign the selling contract. At that moment the obligation of the taxpayers to pay capital gain tax, purchase tax, and the selling tax is abstract because the tax assessments have not yet been prepared, and the amount of the taxes have not yet been calculated.

The tax event of the betterment levy is the day that the zoning plan becomes valid and it raises the value of the land. At that day, the obligation of the taxpayers to pay the betterment levy is abstract because the tax assessment has not yet been prepared.

The tax event of property tax is the first day of the fiscal year i.e. the first of January in many countries. The obligation of the taxpayers to pay the property tax will be crystallized when the tax officer will prepare the tax assessment.

Should the taxpayer submit an appeal against the tax assessment, the final debt will be crystallized on the day that the court or the appeal committee will issue its verdict. The outcome is that the tax event creates only an abstract obligation of the taxpayer to pay his taxes, and his timing is significant to various matters i.e. calculation of interest on the tax and bankruptcy.

5.6.5 The Payment Day

The payment day is the date when the abstract obligation of the taxpayer becomes a debt, which the tax collector is entitled to collect the tax.

In some tax laws, the payment day is right after the tax event i.e. property tax, but usually the tax payer is entitled to pay his debt in a few rates during the fiscal year. In some tax laws, there are several payment days i.e. income tax that obliges to pay advance payments every month even though the tax assessment will be issued much later. The payment day of V.A.T is usually the month following the month that has been assessed.

5.6.6 The Tax Rates

The tax rates are the sums, the percentages, and the rates of the tax. Each tax has a rate and most of the taxes have several rates. The tax rates can be imposed in the main law or in regulations. The tax rates can be defined in fixed sums, in progressive or regressive scales, in percentages of the sum that is part of the tax event i.e. income, turnover, betterment, capital gain or value. The tax rates can be defined in proportion to weight, size, space, number of items etc.[190]

In order to defer the rates, the tax law should define various parameters. Those parameters can relate to characters of the taxpayer i.e. his trade, and of the tax object i.e. land or building.[191]

The sum of the tax is counted usually by multiplying the rate with the amount of the weight, the size, the space, or the number of items.

5.6.7 Exempts and Reductions (Discounts)

The exemptions and rate structure that exist in a tax system are an expression of

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190 At Hamburg every inhabitant is obliged to pay to the state one-fourth per cent of all that he possesses; and as the wealth of the people of Hamburg consists principally in stock, this tax may be considered as a tax upon stock. Every man assesses himself, and, in the presence of the magistrate, puts annually into the public coffer a certain sum of money which he declares upon oath to be one-fourth per cent of all that he possesses, but without declaring what it amounts to, or being liable to any examination upon that subject. This tax is generally supposed to be paid with great fidelity. In a small republic, where the people have entire confidence in their magistrates, are convinced of the necessity of the tax for the support of the state, and believe that it will be faithfully applied to that purpose, such conscientious and voluntary payment may sometimes be expected. It is not peculiar to the people of Hamburg. Smith, Adam. The Wealth of the Nations, book 5, chapter II, Article II - Taxes on Profit, or upon the Revenue arising from Stock, p. 1139. The Electric Book company, London, http://www.elecbook.com/admsmith.zip

191 In the different poll taxes (capitation tax H.R.) which took place in England during the reign of William III the contributors were, the greater part of them, assessed according to the degree of their rank; as dukes, marquisses, earls, viscounts, barons, esquires, gentlemen, the eldest and youngest sons of peers, etc. All shopkeepers and tradesmen worth more than three hundred pounds, that is, the better sort of them, were subject to the same assessment, how great soever might be the difference in their fortunes. Their rank was more considered than their fortune. Smith, ibid, book 5, chapter II, Article IV - Taxes which, it is intended, should fall indifferently upon every different Species of Revenue, p. 1165.

social policy toward institutions that are to be favored, including marriage, schools, charities, churches, and redistribution of wealth and income. Exemptions or low rates on gifts and bequests to spouse and children represent a social policy in favor of the family unit. Provisions in tax laws that favor educational, religious, and charitable organizations reflect a desire to encourage private support of these institutions.

Tax exemptions and rate structure also serve as an instrument for redistributing wealth and income. But, as in the case of the income tax, the methods of avoidance must be considered before any conclusion is drawn concerning the actual impact of death and gift taxes on the distribution of wealth and income.

Almost all tax laws include exempts and reductions. The exempt and the reduction are irregular to the rule of the abstract obligation of the taxpayer that is created at the tax event. Each one of the exempts and the reductions has one or more terms that should exist to imply the exempt or the reduction on the taxpayer. I will define four of the most common terms' groups that occur in most of the tax law to imply the exempts and reductions.

A. Exempt and reduction based on the character of the taxpayer - many exempts and reductions depend on the character of the taxpayer. In Israel, a blind person is exempt from income tax on his salary, public institute is exempt from income tax and land appreciation tax, and elders receive a reduction in their municipal general rate.

The main idea behind these sort of exempts and reductions is that in each society there are members who should pay less taxes or not pay them at all. Ironically, these members may be belonging to the poor class or to the rich.

B. Exempt and reduction based on the character of the tax object - there are tax-exempts and tax reductions, which are granted due to the characters of the tax object. For example, the selling of an apartment has an exempt from capital gain tax (land appreciation tax) in most of the countries.

C. Exempt and reduction based on the geographical location - some exempts and reductions are gratitude for the geographical location of the tax event. There is no V.A.T in Eilat because the government decided to encourage the economy in the southern city in Israel. Citizens that live close to the borders have reductions in income tax. Residents in poor neighborhoods are exempted from a betterment tax.

The idea behind these sorts of exemptions and reductions is that in each country there are areas and zones that the tax attached to them should be less than the rest of the country.

D. Exempt and reduction based on the mixed characters - there are exemptions and reductions that require few conditions, i.e. an exempt from property tax is granted to a tax payer who owns only one apartment, that its' value is less than a certain amount set by the law. This exempt requires three conditions: a tax payer who owns only one apartment, a property that is defined as an apartment, and a price of the apartment which should be less than a certain sum.

Income tax rates could be lowered one-third with no resulting reduction in the amount of money raised if all income were subject to tax and the personal deductions were pruned to the essential items.[192]

5.6.8 Declaration and Self-Assessment

Some tax laws impose a duty on the taxpayer to submit a declaration about various details concerning his tax assessment. Some tax laws, i.e. income tax, impose a duty on the taxpayer to submit a self-assessment that means to calculate the sum of the tax he is obligated to pay. There are tax laws that grant the choice to the taxpayer whether to submit a declaration or a self-assessment.

5.6.9 Tax Assessment

The tax event imposes an abstract obligation to the taxpayer. In order to calculate the sum of the tax that the taxpayer is obligated to pay, a tax assessment must be conducted. The assessment process is an implementation of the abstract concepts, which are included in the tax laws, according to the database of the taxpayer, tax object, tax event, and any other relevant data.

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[192] Pechman, Joseph A. The author of 'Who Paid the Taxes, 1966-85?', quoted in 'The Need for Tax Reform', in The Progress Report, http://www.progress.org/archive/gard05.htm

The tax officer that is called many times by mistake the "tax collector" has to assess the amount of tax that is imposed on the taxpayer. Some tax laws impose a duty on the taxpayer to submit a self-assessment, such as income tax, V.A.T, and inheritance tax.[193]

The income tax, and also other taxes on the transfer of property, such as the inheritance tax, the taxpayer submits a tax return providing information as to his occupation, his real and personal property, his professional expenditures, and other pertinent matters. A corporation supplies, additionally, copies of the balance sheet, profit and loss statement, and minutes of the general meeting that approved these financial reports.

Most tax systems also collect information in other ways, in order to inform the authorities as to potential tax liabilities. Records are kept of such matters as the allocation of income by partnerships, trusts, or estates, and the payment of fees, interest, dividends, and other sums exceeding a certain minimum amount.

The second phase in levying taxes is the calculation of the amount to be paid. In the U.S. self-assessment method, the liability for income tax is primarily established by the taxpayer himself. The final computation of taxes levied on income, on inherited property, or on the transfer of property is made by the tax administration. Sales taxes and value-added taxes are calculated by the taxpayers.[194]

The tax announcement - The assessment process turns the abstract obligation of the taxpayer into a certain sum. Following the assessment process, the tax officer sends the tax announcement to the taxpayer.

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193 “The canton of Unterwald in Switzerland is frequently ravaged by storms and inundations, and is thereby exposed to extraordinary expenses. Upon such occasions the people assemble, and every one is said to declare with the greatest frankness what he is worth in order to be taxed accordingly. At Zurich the law orders that, in cases of necessity, every one should be taxed in proportion to his revenue—the amount of which he is obliged to declare upon oath. They have no suspicion, it is said, that any of their fellow-citizens will deceive them... But it is impossible that they should continue to do so for any considerable time; and if they did, the tax would ruin them so completely as to render them altogether incapable of supporting the state. Smith, ibid, book 5, chapter II, article II - Taxes on Profit, or upon the Revenue arising from Stock, p. 1140.

194 Tax Law, Assessment, Encyclopædia Britannica, Britannica.com editors, http://www.britannica.com/eb/article?eu=115311&tocid=71937#71937.toc

The tax announcement should contain all the details of basic fundaments, such as the name and identity number of the taxpayer, the description of the tax object, description of the tax event, the tax rates, the tax sum, the sums of the exempts and the reductions, and the payment day. In most countries, the tax announcement should contain a note about the rights of the taxpayer to appeal against the tax assessment, to which court or tax appeal committee it should be submitted, and within the time period to submit such an appeal.

5.6.10 Appeal

Any tax law that allows the authority to impose taxes allows the taxpayer to appeal against the imposing of the tax at all, or to appeal against the rates and the sums of the tax that were set in the tax assessment.

Usually, the first stage the taxpayer files an appeal to the tax officer himself. After the tax officer gives his decision to such an appeal, the taxpayer has the right to appeal against this decision to the court or to a tax appeal committee.

The tax appeal committee conducts the legal process of the dispute between the tax officer and the taxpayer. These committees usually contain a chairman, who is a judge or a lawyer, and two other members who are experts in the said tax law. Such committees conduct the process in a similar way of court, hear witnesses, collect documents and experts opinions, and submit its decision.

On the decision of the tax appeal committee, both the taxpayer and the tax officer may appeal to an appeal court, and usually its verdict is final.

5.6.11 Tax Enforcement

Should the taxpayer fail to pay his taxes on the payment day, and if there is no appeal pending against the tax assessment, the tax collector is entitled to collect the debt.

Usually, the collection of tax debt is being carried out via a particular law that grants the tax collector the rights and the power to put enclosure on the property of the taxpayer, and to take any other measures against the person, i.e. arrest, or his assets.

5.6.12 Interest, Fine and Penalties

If the taxpayer fails to pay within the legally prescribed period or within a very short time afterward, the authoritative tax officer is allowed to collect the amount due.

In addition to interest charges on the amount due, various kinds of coercive measures are available to ensure payment. Civil penalties consist generally of a fine when the violation is the result of negligence rather than of willful neglect or bad faith. Examples of negligence are the failure to file a required declaration or self-assessment on time and understatement or underpayment of the tax liability without intent to mislead. Civil penalties are fixed by assessment, so that the procedural remedies of the taxpayer are identical with those provided for the assessment of the tax itself.[195]

In proceedings against the taxpayer, the tax administration is not in the position of an ordinary creditor suing an ordinary debtor. The law grants the tax administration a privileged position on the other creditors of the taxpayer.

5.7 Income Tax

5.7.1 Classification of Profits and Taxes on Profit

The difference between capital gains and profit earnings can be illustrated by an example drawn from the natural world. Fruit trees bear fruit every year, and picking and eating them does not hurt the tree itself. Yearly rental fees from a piece of property are similar to the fruit of a tree, and the use of the rental fees for the needs of the property owner does not harm the property itself.

However, just as the farmer must water the tree, fertilize the ground from which the tree is growing and spray the tree against pests, so the property owner must continuously look after and maintain the property in good order.

When the owner of a grove of fruit trees sells the land or fells the trees to a paper

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[195] Tax Law, Enforcement, Encyclopædia Britannica, Britannica.com editors, http://www.britannica.com/eb/article?eu=115311&tocid=71939#71939.toc

manufacturer, he loses all at once any chance of enjoying the fruit that the tree will produce in the future. When a property owner sells his assets in this same way, he will also lose, all at once any and all future rental income from said property.

The profit gained by selling a capital property is called "capital gains". When an owner of property leases a property for the use of others, he receives a rental fee in exchange and this income is considered profit earnings.

5.7.2 Income Tax on Profits of Real Estate

Income tax is also imposed on profits of real estate. In the calculation of this profit, the devaluation of the rented property is subtracted from the income received from said property. The amount of the devaluation is meant to reflect the drop in the value of the property for as long as the property has existed. The quality of the materials used in the construction and what the property is used for determine this. In fact, the tax law itself determines the annual devaluation rate for tax purposes, and there is no practical importance of this matter during the expected life span of the rented property.

There is a standard depreciation period for most buildings, determined by each income tax law, i.e., in Israel the depreciation is 2% per annum of the construction costs, exclusive of land cost. That is to say that the entire price that was paid for the construction of the building devaluates in periods over 50 years. According to other tax laws, a different annual depreciation rate was set such as 4% per annum, and the full price of the construction is devalued during only 25 years. With regard to industrial properties, their devaluation rate is more significant, assuming that the life span of these properties is shorter than properties that are used for residential, office, or merchandizing.

When a taxpayer purchases a plot of land and builds a structure on it, the value of the land is not devalued as far as the taxes are concerned only the building. After all, the life expectancy of the land is forever. However, when a taxpayer buys an existing structure, the tax law establishes a legal presumption, according to which a fixed portion of the price refers only to the building, and the devaluation for the tax assessment is calculated on this portion. For this purpose there is no significance with regard to the market value of the land itself or to the cost of constructing a similar building.

From the income received from the lease of land the taxpayer is entitled to deduct the interest he pays on the loans he has taken in order to purchase the property. This benefit encourages investors to finance a large part of the cost of purchasing the land with long-term bank loans. The interest rate of the bank is influenced by the inflation rate of the same period, in other words, by the deflation of the buying power of money, plus the profit that the banks are asking for the use of the money.

If there occurs a period of time during which the inflation is very high, the yearly interest rate is liable to increase to the same amount as the yearly rental fees of the property. This still allows the property owner to keep his entire income without paying tax at all. In countries where inflation is rampant, income tax laws are amended on a regular basis because the rate of annual inflation is to be deducted from the interest rate that is recognized by the tax authorities as an expense. In this way, only when an interest rate surpasses the inflation rate it is recognized as an expense. The basic concept here is that real estate always retains its real value and its market value is not influenced by inflation.

Tax purposes dictate that ongoing maintenance and repair fees are also to be deducted from rental income, as well as management fees and collection expenses. For the calculation of taxable yearly profit, the following are deducted from the rental income: recognized devaluation rate, interest paid on the loan used to purchase the property and the expenses incurred from the collection of rent. Income tax is paid on the balance.

5.7.3 Corporation Tax

Federal state or local government imposes on the corporation an income corporation tax. The separate taxation of the incomes of corporations and their shareholders follows the legal principle that they are distinct entities.

A tax may have to be assessed on corporations to prevent shareholders from escaping current taxation on undistributed profits. Their shares appreciate in value, converting this income into capital gains, which in most countries either are taxed at lower rates than ordinary income or are free of income tax.

A corporation income tax also enables a country or state to tax profits earned within its borders by corporations whose shareholders reside elsewhere. Corporation income taxes are mainly flat-rate levies, rather than extensively graduated taxes with rates rising according to income as in the typical individual income tax.[196]

In 1909 the federal government imposed an excise tax on the net income of U.S. corporations. That tax was superseded by a corporation income tax after the Sixteenth Amendment (1913). In Great Britain, in 1920 a tax was levied on corporations, including foreign companies of limited liability doing business in the United Kingdom, but exempting the profits of corporations receiving income from other corporations already taxed. In both the United States and Great Britain, excess profit tax has generally been imposed only during wartime.

5.7.4 Capitation Tax

An ancient form of income tax is the capitation tax that was diminished in the 20th century. The capitation tax was a major direct tax in France before the Revolution of 1789, first established in 1695 as a wartime measure. Originally, the capitation was to be paid by every subject, the amount varying according to class.

While the rates of the income tax are progressive, the rate of the capitation tax is imposed indifferently upon every different type of revenue, the rent of the land, the profits of the stock, or from the wages of the labour.

"Capitation taxes, if it is attempted to proportion them to the fortune or revenue of each contributor, become altogether arbitrary... This assessment, therefore, must in most cases depend upon the good or bad humor of his assessors, and must, therefore, be altogether arbitrary and uncertain."[197]

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196 Income tax, corporate, rationale of the corporation tax, Encyclopædia Britannica, Britannica.com editors, http://www.britannica.com/eb/article?eu=115313&tocid=71960

197 Smith, Adam. The Wealth of the Nations, book 5, chapter II, article IV - Taxes which, it is intended, should fall indifferently upon every different Species of Revenue, p. 1164. The Electric Book company, http://www.elecbook.com/admsmith.zip

5.7.5 The Negative Income tax

The idea of a negative income tax has been considered in the United States as a method of providing very low-income families with a stable subsistence level of income in the form of government payments geared into the personal income tax structure. It is viewed as a possible substitute for public assistance or as an alternative to family allowances.

The basic idea behind this is to guarantee a minimum level of income adjusted to the size and composition of the family unit. It has to guarantee a tax rate to be applied to the difference between the family's income and some specified amount, and a break-even level of income at the point at which the tax liability equals the guaranteed allowance.

The earned income tax credit in the tax law of the United States amounts to a form of negative income tax, but it is available only to those who are employed and supporting dependent children.[198]

5.8 Capital Gains Tax (Land Appreciation Tax)

When the owners of real estate sell the properties at a higher price than that which was paid for, the profit is considered capital gains. In many countries there is a capital gains tax[199] on this profit.

In order to calculate the profit which results at the time the property is sold, the cost of the property, plus the expenses incurred in the upgrading of the property, obligatory payments of any kind, and sometimes also the interest that the owner pays on the loan taken in order to purchase the property, are deducted from the price of the sale of said property.

This rule encourages investors to finance a large part of the cost of the property with long-term bank loans. Obviously, the expenses cannot be claimed twice, meaning, in the assessment of taxable income regarding a rental property and also

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198 The Negative Income tax, Encyclopædia Britannica, Britannica.com editors, http://www.britannica.com/bcom/eb/article/0/0,5716,115312+9,00.html

199 Known also as a Land Appreciation Tax.

in the calculation of capital gains at the time of sale of this same property.

There are countries in which the holding of property for a period of a few years relieves the seller of the capital gains tax, i.e. Germany and Poland. Generally, in these countries a property tax is imposed on the net capital, and sometimes combined with a gift tax and an inheritance tax.

The taxation of capital gains and losses presents a special set of problems to which different countries have found different answers. An increase in the value of a capital asset, a share of stock, a corporate or government bond, or real estate, increases the net worth of its owner, and thus, it can be seen as a form of income. There is a problem, however, of valuing all of the capital assets a taxpayer may own so as to be able to determine how much his net worth has increased or decreased during the taxable year. In practice, this difficulty has usually been avoided by taking into account only those gains and losses that have been realized in the form of cash or its equivalent.

Even realized capital gains may present a problem of valuation. During an inflationary period, an increase in the monetary value of an asset may not mean that there has been an increase in the real inflation-adjusted value of the asset. The conceptually correct solution to this problem is to adjust the cost of the asset for inflation.

The knowledge that capital gains are subject to very heavy taxes upon realization can deter individuals subject to high-bracket rates from making investment decisions that are socially desirable. This difficulty is usually handled by taxing such gains at a relatively low rate or by excluding a stated percentage of the gain from taxable income. In either case, this special treatment applies only to long-term gains involving assets that have been held for a minimum length of time.

Some countries, including Canada, France, and Germany, do not tax capital gains unless they arise out of a business. The line between a business transaction and a personal one is not easy to draw. Moreover, the exemption of capital gains provides tremendous pressure to re-characterize ordinary taxable income as exempt capital gains.

Countries that do not, in principle, tax individuals on their capital gains also do not allow capital losses to enter into the determination of taxable income. Those that do tax capital gains ordinarily take capital losses into account only as offsets to capital gains. Even then, deductions of losses are usually limited to prevent abuse.

In Israel, there is a capital gains tax on the sale of moveable possessions and property at the same rate as income tax except for those instances in which the property was purchased on or before March 31, 1961. [200]

In order to calculate the profit, which results at the time the property is sold, one should consider the following components -

A. The cost of the property, plus the expenses incurred in the upgrading of the property.
B. Compulsory payments i.e. purchase tax, property tax, and betterment levy.
C. The interest that the owner pays on the loan had taken in order to purchase the property.[201]

5.9 Taxes on Turnover

5.9.1 Purchase Tax

Purchase tax is imposed on the buyer of real estate, and its' rate is usually between 1% up to 5% of the property price. The tax rate can be a flat rate and it may be regressive one. Sometimes this sort of compulsory payment is known as stamp tax and it may be a combination of both of these taxes. When an entrepreneur or contractor purchases land and sells apartments, purchase tax is paid twice - once in each transaction.

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200 Israel Law Book, Land Taxation Law (Appreciation, Selling, and Purchasing), 1963, article 48; Income Tax Ordinance, chapter 5.

201 The cost, the compulsory payments, and the interest may be deducted from the price of the sale of said property. This rule encourages investors to finance a large part of the cost of the property with long-term bank loans. Obviously, the interest cannot be claimed twice - in the assessment of taxable income regarding a rental property and also in the calculation of capital gains at the time of sale of this same property.

5.9.2 Selling Tax, Stamp Duty

Selling tax is imposed on the seller of real estate, and its' rate is usually between 1% to 2.5% of the property price.

"The transference of stock, or movable property, from the living to the living, by the lending of money, is frequently a secret transaction, and may always be made so. It cannot easily, therefore, be taxed directly. It has been taxed indirectly in two different ways; first, by requiring that the deed containing the obligation to repay should be written upon paper or parchment which had paid a certain stamp-duty, otherwise not to be valid; secondly, by requiring, under the like penalty of invalidity, that it should be recorded either in a public or secret register, and by imposing certain duties upon such registration."[202]

5.9.3 Value Added Tax - V.A.T

The value-added tax is a government levy on the amount that a business firm adds to the price of a commodity during production and distribution of a good. Three major types of value-added tax have been identified, depending on the deductions allowed, but only one--called the consumption type--is widely used today.[203]

Calculation of the value-added tax of the consumption type can be made in any of three different ways, but virtually every country imposing the tax uses the "invoice," or "credit," method of computation. Using this method, each seller first calculates the sum of all the taxes that he has collected on goods sold. He then totals the sum of all the taxes that he has paid on goods purchased. His net tax liability is the difference between the tax collected and the tax paid.

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[202] Smith, Adam. The Wealth of the Nations, book 5, chapter II, appendix to articles I and II - Taxes upon the Capital Value of Land, Houses, and Stock, p. 1151. The Electric Book company, http://www.elecbook.com/admsmith.zip

[203] "The impossibility of taxing the people, in proportion to their revenue, by any capitation, seems to have given occasion to the invention of taxes upon consumable commodities. The state, not knowing how to tax, directly and proportionably, the revenue of its subjects, endeavours to tax it indirectly by taxing their expense, which, it is supposed, will in most cases be nearly in proportion to their revenue. Their expense is taxed by taxing the consumable commodities upon which it is laid out". Smith, ibid, Article IV - Taxes which, it is intended, should fall indifferently upon every different Species of Revenue.

It is generally assumed that the burden of the value-added tax, like that of other sales taxes, falls upon the final consumer. Although the tax is collected at each stage of the production-distribution chain, the fact that sellers receive a credit for their tax payments causes the tax, in effect, to be passed on to the final consumer, who receives no credit. Most countries have at least partly avoided this effect by applying a lower rate to necessities than to luxury items. [204]

In 1954 France was the first country to adopt the value-added tax on a large scale. In 1968 West Germany adopted the value-added tax, and since then most other western European nations have followed suit, largely as the result of a desire to harmonize tax systems.

5.10 Luxury tax

The luxury tax is an indirect tax, similar in that way to the V.A.T. The luxury tax is imposed on products that are defined by the law as "luxurious" ones. The idea behind this tax is implicated in many states in the different rates of the V.A.T. that imposes higher rates upon so called luxurious articles and services, while the common ones benefits lower rates.[205]

The consumers of the commodities finally pay the luxury tax, and it falls indifferently upon the wages of labour, the profits of stock, and the rent of land. One may say that this tax is finally paid partly by landlords in the diminished rent of their lands, and partly by rich consumers, whether landlords or others.

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204 Value added tax, Encyclopædia Britannica, Britannica.com editors, http://www.britannica.com/eb/article?eu=76704&tocid=0

205 "It is otherwise with taxes upon what I call luxuries, even upon those of the poor. The rise in the price of the taxed commodities will not necessarily occasion any rise in the wages of labour. A tax upon tobacco, for example, though a luxury of the poor as well as of the rich, will not raise wages. Though it is taxed in England at three times, and in France at fifteen times its original price, those high duties seem to have no effect upon the wages of labour." Smith, Adam. The Wealth of the Nations, book 5, chapter II, article IV - Taxes upon Consumable Commodities, p. 1170. The Electric Book company, http://www.elecbook.com/admsmith.zip

5.11 Custom, Import Tax

The custom is imposed on imported commodities, and it is also called tariff. Governments since ancient times have used tariffs, although they were originally sources of revenue rather than instruments of state economic policy. Early customs duties consisted of payments for the use of trade and transportation facilities, including ports markets, streets, and bridges.

Custom may be distinguished from other taxes in that their predominant purpose is not financial but economic not to increase a nation’s revenue but to protect domestic industries from foreign competition. For that reason, advocates of free trade, oppose protective tariffs.

"They seem to have been called customs as denoting customary payments, which had been in use from time immemorial. They appear to have been originally considered as taxes upon the profits of merchants."[206]

5.12 Property Tax, Capital Net Tax, Land Tax

5.12.1 Property Tax

Property tax is imposed on the owner of real estate. The property tax of the ancient world was originally a land tax based on an area rather than on value. Eventually, the product of the rural land came to serve as the base of the tax.

In some countries the property tax is imposed on the general property value. Yet to reach movable property effectively for taxation purposes it has always been difficult, and taxing intangible forms of wealth has proved even harder.

The assessed value is what the taxing authority (county, city or town) uses to determine how much tax is due. In some cases, the assessed value might be the same as market value, but typically it is a percentage, called the assessment ratio.

Property tax is a levy that is imposed primarily upon land and buildings. In some countries, including the U. S., the tax is also levied upon business and farm

[206] Smith, ibid, p. 1179.

equipment and inventories. Sometimes the tax extends to automobiles, jewelry, furniture, and even to such intangibles as bonds, mortgages, and shares of stock that represent claims on, or ownership of, tangible wealth. The amount payable is based not on a person's or a company's total net wealth but on gross value without regard to debts.[207]

"In its most comprehensive form, the property tax would encompass within its base the value of all property including land, any structures on the land, producer and consumer durable goods, business inventories and holding of government bonds and cash."[208]

In some countries, i.e. Germany, the property tax is imposed on the net capital, meaning, on the value of the capital assets minus the loans, which were taken for the purpose of purchasing these assets.

5.12.2 Land Tax

The land tax is a sort of a property tax, which is imposed on real estate assets owned by the taxpayer.[209] "A land tax is a fixed periodic charge. It is based on qualities inherited in the land with few concessions to the landholder's personal illiquidity weakness, setbacks, or aging. 'Use it or sell it' is the message, which many consider too harsh… The land tax may be based on the current potential rent, or on value. In most countries other than Britain it is the latter. Values are not simply proportional to rents because many land values are elevated above that by expected higher future rents."[210]

The land tax was basically imposed in the ancient society on rural land. It may have the form of tax or a form of rent paid by the farmers to the landlord. That kind of rent could not be interpreted as rent nowadays, because the vast country

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207 Property tax, Encyclopædia Britannica, Britannica.com editors, http://www.britannica.com/eb/article?eu=115315&tocid=0

208 "Property taxation", Etwell, John (ed). The New Palgrave a Dictionary of Economics, volume 3, p. 1034, the Macmillan Press Limited, London, 1987.

209 See paragraph 4.5 on "single tax".

210 Land tax, volume 3, p. 123, ibid.

belonged to few noble families, counts and dukes, and there was no free market for rural land.

In many countries, a separate assessment procedure has been organized for income from real property; such is the case in the various European countries in which the French system of land register was introduced at the end of the 18th century. The theoretical income of each piece of real property is then determined by the administration of the land register and remains fixed for a relatively long period, except when important changes are made in the property.[211]

In Israel, property tax is imposed only on land, which is not built up. The rate of this property tax is generally 1%-2.5% from the market value or from the assessed value of the property, and the loans taken are not deducted. This tax has been abolished on January 1, 2000.

5.13 Estate Tax, Inheritance Tax, Gifts Tax

5.13.1 Estate Tax (Death Tax)

Estate tax, inheritance tax and gift tax are levies imposed on gratuitous transfers of property--that is, transfers made without compensation in either money or its equivalent. In this respect, they differ from sales taxes imposed on transfers made in exchange for something of value, from property taxes and capital levies that are based on the mere ownership or possession of property and from income taxes levied on earnings.

Death in many countries is considered to be a tax event, one that prompts the imposition of a levy by the state. Death taxes are of two kinds: those imposed on the property left at death are known as estate tax and those imposed on the acquisition of property from a person who has died is known as inheritance tax. The two kinds of death taxes are sometimes both used in the same system.[212]

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211 Tax Law, Assessment, Encyclopædia Britannica, Britannica.com editors, http://www.britannica.com/eb/article?eu=115311&tocid=71937#71937.toc

212 Death and gift tax, Encyclopædia Britannica, Britannica.com editors, http://www.britannica.com/eb/article?eu=115317

Estate tax is a levy on the value of property changing hands at the death of the owner, fixed mainly by reference to its total value. Estate tax is generally applied only to estates evaluated above a statutory amount and is applied at graduated rates.

The main argument against death tax rests on its possible negative effects on incentives. The argument is that the person building up an estate will be less inclined to do so if he knows a large part of it will never go to his heirs. An economic limit to the usefulness of death taxes may be said to exist when the accumulation of wealth is discouraged to the point of hampering the growth of the economy.

5.13.2 Inheritance Tax

Inheritance tax is a levy on the property accruing to each beneficiary of the estate of a deceased person. Reference to the amount received and the relationships of the beneficiary to the deceased usually calculate the inheritance tax. In some systems, the value of the property already owned by the beneficiary also enters into the calculation.

Inheritance tax may be more difficult to administer than estate tax because the value passing to each beneficiary must be fixed, and this often requires complex actuarial calculations.[213]

The economic effects of inheritance tax are unimportant by the usual criteria. There is little reason to believe that a person will alter his consumption patterns because of the prospect of inheritance tax. The main effect of inheritance and gift taxes has been to encourage estate planning and the employment of legal devices to minimize taxes rather than to change behavior.

A significant effect that is often overlooked is that on business structure and practices. This stems from two problems that exist in death taxation. One of these is that of setting a valuation on the estate for tax purposes. Another is the problem of liquidity i.e., getting the cash with which to pay the taxes.

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[213] Inheritance tax, ibid, http://www.britannica.com/eb/article?eu=43382&tocid=0

The valuation of an estate suffers from the same problems as the valuation of any property. There may not be an active market in the various assets involved. The assets may be unique in some sense. Appraisers may be called in to set a value on the property, but their evaluations may vary widely.

Even if there were certainty in the valuation of an estate, there remains the problem of paying the taxes. The gravity of this problem depends partly on the nature of the assets in the estate. If they are shares of stock that are traded on a national stock exchange there is relatively little difficulty. If a family-owned business or a major portion of any business is involved, serious losses, including a change of control of the business, may result from attempts to liquidate the ownership interest in order to obtain cash. Thus, the problem of liquidity presents a major consideration in estate planning.

In spite of all efforts to mitigate the impact of estate taxes, there is a strong temptation for an owner to convert his assets into a highly marketable, easily evaluated form while he is alive. This may require their sale to another company, either for cash or for nationally traded securities. The result is a merger or absorption of the smaller company and an increase in the concentration of economic power, the opposite of what the taxes are meant to achieve.[214]

The inheritance tax exists in many European countries and in the U.S., The American government announced in the year 2000 that the inheritance tax would gradually abolish in the following five years. In Israel, the inheritance tax has been abolished since 1981.

5.13.3 Gift Tax

The gift tax is imposed on gratuitous transfers of property. This tax is common. In the tax systems of many nations, gift tax is integrated to some degree with a death

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[214] "The 'Vicesima Hereditatum', the twentieth penny of inheritances imposed by Augustus upon the ancient Romans, was a tax upon the transference of property from the dead to the living. Dion Cassius, the author who writes concerning it the least indistinctly, says that it was imposed upon all successions, legacies, and donations in case of death, except upon those to the nearest relations and to the poor." Smith, Adam. The Wealth of the Nations, book 5, chapter II, appendix to articles I and II - Taxes upon the Capital Value of Land, Houses, and Stock, p. 1152. The Electric Book company, http://www.elecbook.com/admsmith.zip

tax. In some nations[215] the explicit rationale for gift taxes, is to avoid the use of gifts as a means of avoiding death taxes.

Nevertheless, a moderate gift to relatives may be exempt from a gift tax, so the taxpayer is able to transfer part of his assets to his heirs during some period of time without paying a gift tax or inheritance tax.

5.14 Municipal Levies

Local authorities are entitled by the law to legislate tax laws. The main purpose is to enable the local authorities to finance their own budget without the support of the state Treasury. Each one of the local authorities is responsible to balance its budget by calculating the amount of the taxes and expenses. That autonomy causes different rates of taxes among the local authorities.

State compulsory payments are named as tax and duty while local authority compulsory payments are named as levy and rate. Those compulsory payments may be alike in nature and purpose, but the different names should indicate the difference in the sort of the authority that imposes those compulsory payments.

"In the spirit of the Tiebout model (1956), individuals 'shop' among these communities and select as a jurisdiction of residence the community offering the most attractive fiscal package. In this framework, the property tax becomes a kind of price or 'tax-price' for the consumption of local public goods. Higher taxes here reflect a higher output of local services."[216]

In most of the local authorities, one can find three sorts of taxes -

A. **Municipal Property Levy** - Imposed mainly on the owners of land and structures within the jurisdiction of the local authority, and is similar to the property tax.

B. **Betterment Levy** - Imposed mainly on the owners of land within the jurisdiction of the local authority, due to finance the budget of the

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215 Canada, Sweden, Germany, and France.

216 Property taxation, Etwell, John (ed). The New Palgrave a Dictionary of Economics, volume 3, p. 1035, the Macmillan Press Limited, London, 1987.

constructing department of the local authority and the general development expenses, and is similar to the land appreciation tax.

C. **Development Levies and Rates** - Imposed mainly on the owners of land and structures within the jurisdiction of the local authority, and is due to finance the budget of specific development expenses.

The sum of the land tax that is raised by the state is divided in many countries between the state Treasury and the local authorities. Most of the land tax in the country is laid upon its' rural land, and in towns it is assessed upon buildings.

5.14.1 Municipal Property Levy

The municipal property levy is a form of land tax imposed by the local authority on the owners of the land and structures within the jurisdiction of the local authority. The municipal property levy may be imposed in addition to a state property tax or instead of it.

The municipal property levy rate is due to the market value of the land, and it causes many appeals against the tax assessments by the taxpayers. The rates of the property levy vary among jurisdictions therefore entrepreneurs and capital will tend to migrate from high to low-tax jurisdictions. High rates in a city may reduce the income of the real estate owners and decrease the value of the property. High-taxed local authority may collect more taxes at the beginning, but in the long run, entrepreneurs and capital will move to a low-tax jurisdiction, and the high rates will be imposed on a much smaller volume of equity.[217]

In Israel, there is no municipal property levy and instead there is a municipal general rate.[218] This rate is imposed on the person that uses the land or the building whether this person is the tenant or an owner who uses his own real estate. This levy is imposed on structures and on land that is used for commercial or rural purposes.

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217 Ibid.

218 This property levy is named "arnona" and is the main source of the budget of the local authorities. There are different rates for each kind of use of the structures and land and different rates in any local authority. Rostowicz, H. Municipal General Rate, Oryan publishing (1995), IV ed., pp. 125-171.

5.14.2 Betterment Levy

The betterment levy, also known as a re-zoning tax, is a levy on the property that its value grew by the zoning process, and it is mainly imposed on the owner of the land. It is calculated by real estate appraisers that appraise the value of the land before and after the zoning or rezoning process. The added value of the land is a sort of profit, and the tax is imposed on it.[219]

Zoning is the legislative method of controlling land use by regulating such considerations as the type of buildings (*e.g.,* commercial or residential) that may be erected and the population density. It is applied primarily to urban areas, and is accomplished by dividing land area into zoning districts, each having specific conditions under which land and buildings may be legally developed and used. In combination with other city-planning techniques, zoning is a major instrument for gaining greater physical order in cities.[220]

5.14.3 Development Levies and Rates

In order to develop modern urban zones, the local authorities should commit the environmental works. Environmental works are the infrastructure that provides cities and towns with water supply, waste disposal, and pollution control services. They include extensive networks of reservoirs, pipelines, treatment systems, pumping stations, and waste disposal facilities. The local authorities should build the roads within their jurisdiction.

To finance these costs, the local authorities impose fees on the owner of the land that are located in the area of the development zone. The rate of these fees should be proportional to the costs of the development expenses.

5.15 Tax Shelter

Tax shelter, which is known as tax haven, is the goal of the taxpayer and the nightmare of tax collector. Tax is a compulsory payment imposed by a law. There

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219 Rostowicz, H., Gladkov, P., Kamil, A., Friedman A. Betterment Levy, Oryan Publishing, 1996.

220 Zoning, Encyclopædia Britannica, Britannica.com editors, http://www.britannica.com/eb/article?eu=80546&tocid=0

is no perfect law, and each one has it loopholes. Finding these loopholes creates the tax shelters, and once the legislator amends the tax law, new loopholes are usually created, and new tax shelters requires new amendments.

In the shrinking modern economic world, international corporations can easily transfer profits into low rate income tax countries and into offshore companies and avoid income taxes. Inheritance tax can be avoided by gifts and funds, i.e. in the U.S., and custom can be significantly reduced by importing components instead of final products, and by using treaties that allow duty free import from nominated countries.[221]

Taxes imposed on real estate are the most difficult to avoid. Owner of real estate can not avoid property tax neither can he move his plot into a low rate property tax country or register it in an offshore dominion. Land appreciation tax, if exists, is impossible to avoid once the tax payer sells his real property, and purchase tax can not be avoided by the buyer.

This dissertation tries to deal with diminishing and avoiding land appreciation tax, and purchase tax, by pointing to two legal methods of irregular selling and buying of real property directly and indirectly. These methods can be used as marketing strategies to perform economic activity in the real estate market via tax shelters.

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[221] "The vitality of the sales tax as a critical state and local government revenue source has been eroded in recent years by the rapid growth in mail order and Internet sales. Sales taxes are due on mail order and Internet purchases just as they are on purchases in stores. But a large majority of the sales taxes due on mail order and Internet purchases made by individual consumers and a significant share of the taxes due on purchases made by businesses are effectively uncollectible. States and localities are unable to collect these taxes because the Supreme Court has prohibited states from requiring mail-order and Internet merchants to charge the customer for the tax and remit it to the customer's state *unless* the merchant has a physical presence or "nexus" within the state's borders. This means that although an Internet merchant like Amazon.com presumably has customers in every or nearly every state, it can only be required to collect sales tax from customers in its home state of Washington and a handful of other states in which it has built warehouses or stationed personnel." Mazerov, Michael. Should the Internet Remain a Sales Tax Haven? Center of Budget and Policy Priorities, http://www.cbpp.org/12-13-99tax.htm

Chapter 6 Selling Real Estate via REA

6.1 Real Estate Association (REA)

Man is a natural legal entity, and is entitled to legal activities - to buy, to sell, to sign various contracts and perform other associated acts. If one is a juvenile, these activities are performed in his name by his parents, or some other legal guardian. Artificial entities are entitled to carry out these legal activities. These artificial entities are called corporations.

Corporations are companies and partnerships generally established for the purpose of making and handling a profit. Non profit organizations are generally established for the purpose of some activity for public or social benefit, which yield no profit. Trust funds are for the purpose of some pre-planned activity, and special tasks, which serve a specific legal purpose such as administrator general.

In this chapter, I will address the subject of a company that is purchasing land or buildings. This company will be called "Real Estate Association" (hereinafter: "REA"). The REA will not sell real estate or take part in the construction of any building on the land and will not be involved in any economic activity of any kind within the realm or scope of trade.

This REA is established for the purpose of marketing real estate in an unconventional method. This marketing should be performed by means of the sale of REA's "special shares" and their allocation to different buyers, whilst the ownership of said property remains that of the REA.

The municipal and state authorities administer the registry of ownership of property in the public property records. A notary or attorney at law transacts the trade agreement between the buyer and the seller. Commonly, at the close of the deal, the buyer is registered in the public property records.

There are three purposes and benefits in marketing real estate using the REA's unconventional method: (a) avoiding red tape and law restrictions, (b) anonymity of the real estate owner, and (c) tax shelter.

A. Avoiding red tape and law restrictions - The first goal of the REA is to market indirectly the equity of the property that is owned by it thereby, avoiding red tape and law restrictions -

I No necessity of contracts for the sale of the property;

II No need to register the buyers in the public property records; and

III Not being subject to the laws governing purchasing and owning real estate.

The result is that in the first stage the REA purchases the ownership of the property according to property law, and is registered as the owner of the property in the public property records. The following stage is that the REA markets the equity of the property in a completely revolutionary way.

B. Anonymity of the real estate owner - The second goal of marketing property equity via the REA is to protect the anonymity of the buyer. When one purchases real estate and is registered as the owner, this becomes public knowledge. When one becomes the owner of shares in the REA, his name is not written in the public property records but only in the company registry. This registry is also open to public scrutiny. REA shareowners that choose to remain anonymous can accomplish this in a way that will be detailed later on in this chapter.

C. Tax shelter - The third goal of marketing property via the REA is the saving of tax payments. There are two principal taxes which can be saved: the purchase tax which is imposed on the buyer of property, and the capital gains tax which is imposed upon the seller of the property, taking into consideration the profit that is created by the sale of the property.

6.2 The Legal Structure of the Real Estate Association

A limited company has shares, and every share entitles the owner to certain rights. The rights of certain types of shares are determined by regulations that have been set down in the memorandum by the founders of the company. The shares of a limited company grant their shareholders four principal rights -

a. The right to participate in the voting at council meetings of the company;
b. The right to appoint the directors of the board of the company;
c. The right to dividends earned by the company; and
d. The right to obtain a portion of assets in the liquidation process.

When a limited company has only one type of share, it is generally termed "ordinary shares". Those shares entitle the shareholder to all available rights, including the four principal rights mentioned above. Besides the ordinary shares a limited company may issue "special shares", which represent special rights. These special shares will entitle their shareholder to those rights that are determined in the memorandum.

In the example of the REA illustrated in this chapter, it is a limited company that has two types of shares -

a. "Ordinary shares" that entitle the shareholder to the four principal rights mentioned above;
b. "Special shares" that entitle the shareholder to the exclusive rights in a specific asset owned by the REA. Those exclusive rights may entitle the shareholder -
    I to occupy this asset;
    II to lease this asset and to receive rental income;
    III to build on the land or to enhance any construction already on it;
    IV to obtain the assets in the liquidation process; and
    V any other legal rights associated with this specific asset.

In this way, if an entrepreneur wishes to purchase real estate, i.e. a building that has 20 residential units and 4 stores, or land for the construction of a building such as this, he should establish an REA, which has 100 ordinary shares and 24 numbered special shares.

Each "special share" entitles its shareholder all the rights of a certain residential unit or a certain store. These shareholders will not have the right to participate in the general assemblies of the company, appoint directors, receive dividends, or receive any assets of the company in liquidation or receivership, except with regard to said specific asset. The 100 ordinary shares are issued to the entrepreneur while the 24 special shares will be issued or sold to the customers.

6.3 Purchasing Real Estate by the REA

In order to attain the three goals of the REA, the entrepreneur must establish the REA in a certain way and obtain, where necessary, permits from the Treasury of the country in which the asset lies.

In many countries there is no limit to the acquisition of property, whether the buyer is a citizen or resident of that country or a foreign citizen. Nor is there any limitation on the acquisition of property by an association whether the association is registered in that country or a foreign country.[222] In these cases there is no problem to purchase real estate by the REA.

There are certain countries where there are considerable limitations regarding the acquisition of land by foreign residents.[223] In these countries there are also limitations regarding the purchase of land by foreign companies, and upon the establishment of locally registered companies by foreign citizens or foreign corporations and associations. Within the framework of these limitations, it is possible, however, to establish a company with joint ownership between a citizen of that country and a foreign citizen; i.e. a "joint venture", and this type of company is granted a license by the Treasury.

The entrepreneur must establish an REA that has the two types of shares mentioned above. The local citizen will own the ordinary shares while the foreign citizen or corporation will own the special shares. After the license has been granted, there are usually no limitations on the transfer of the special shares to another foreign citizen or foreign corporation.

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[222] This list includes most of Western Europe, North America, Israel, etc.

[223] This list includes the countries of Eastern Europe. Recently, there have been legislative efforts made to ease these limitations, and since 1999 it is legal for foreign citizens to buy residential apartments in Poland.

There may exist legal limitations upon the transfer of shares in the REA between foreign citizens or corporations. The original model should be ratified, and the entrepreneur must establish a domestic REA and a foreign holding company that is an additional REA and owns all the shares of the domestic REA or at least the 24 special shares.

The foreign REA has 24 numbered special shares as well, (hereinafter "mirror shares") each one reflecting all the legal rights and economic equity of a specific special share in the domestic REA. The 24 mirror shares in the foreign REA will be sold to the customer. Each shareholder of a mirror share in the foreign REA has indirect ownership of a special share in the domestic REA, which entitles him an indirect ownership in a specific asset owned by the domestic REA.

For example, a Romanian domestic REA is the registered owner of 20 residential apartments and 4 stores in Oradia. Special share numbered 7 represents an apartment on the third floor of 100m^2 according to its regulations. A REA registered in Spain is the owner of the 24 special shares in the domestic REA including the special share numbered 7. The Spanish REA issues 24 special shares of its own. Special share numbered 7 in the Spanish REA represents according to its regulations the legal rights and the economic equity of special share numbered 7 in the domestic REA. The owner of special share numbered 7 in the Spanish REA obtains the legal rights and the economic equity of special share numbered 7 in the domestic REA, and therefore he obtains the legal rights and the economic equity of the said apartment on the third floor in Oradia.

6.3.1 Avoiding Red Tape and Law Restrictions

In those countries where there is a limitation upon the purchase of land via foreign corporations, frequently a special license is granted to purchase a certain parcel of land or property by means of a foreign corporation.

After the license is granted, the REA is established, and the domestic REA is registered as the owner of the property there aren't any more restrictions in transferring the special share in the foreign REA from one shareholder to another.

6.3.2 Anonymity of the Real Estate Owner

The names of the shareholders of a corporation are registered in the public records of the Corporation Registry. However, there are countries i.e. Switzerland that do not register shareholders in the public records of the Corporation Registry and the shareholder is considered the person who holds the share itself. The attorney at law who represents the shareholder, and who has registered the corporation, has his own private registry and the local laws protect access to this registry. The result is that other than the shareholders, only the local attorney at law has access to the names of the shareholders of that corporation.

The entrepreneur's choice among these alternatives is a function of the local laws where the property lies and the necessary demands of the potential purchasers of the property. The second objective of marketing property by means of the REA is to protect the anonymity of the purchaser. If the entrepreneur is convinced that the potential buyers of property will want to remain anonymous, he must choose to establish a foreign off shore corporation even if there is no limitation upon the purchase of land in a specific country by a foreign citizen or corporation.

6.3.3 Tax Shelters in the REA

The third purpose of establishing an REA is to avoid paying taxes; i.e. purchase tax which is imposed upon a buyer who buys directly and capital gains taxes[224] which are imposed upon the seller of said property, with regard to the resulting profit of the sale.

Foreign corporations are called, "offshore company" and can be registered in countries that specialize in international tax shelters.[225] In these countries there is no income tax imposed upon these corporations and their foreign shareholders. These corporations and their foreign shareholders are exempt from the declaration of income and property, from the obligation to produce financial reports. They are obligated to pay only a yearly fee to the local Company Registry, as well as the retainer fees paid to the law firm who has registered them.

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[224] The Capital Gains Tax is also known as Land Appreciation Tax.

[225] Switzerland, Vaduz, The Antilles Island and many more.

When the entrepreneur purchases the land or the building via the REA, he is obligated to pay a purchase tax or a stamp tax. When the customer buys a special share or a mirror share in the REA, there is no obligation to pay purchase tax, because he did not buy real estate. At the same time, the entrepreneur who sells the special share or a mirror share has no obligation to pay capital gains tax because the REA is registered as an off shore company.

The customer who sells the special share or a mirror share has no obligation to pay capital gains tax or income tax because the REA is registered as an off shore company, nor does he have the legal obligation to declare upon this sale.

6.4 Marketing Methods via the REA

In this chapter I have presented an untraditional method of buying and selling real estate assets. Instead of performing a direct sale of real estate to the customer, the suggestion is to perform an indirect sale of real estate by performing a direct sell of shares in REA. Instead of registering the buyer in the land public records and the granting of a real estate ownership certificate, there is a confidential registration by the law firm in the off shore company. A share certificate is granted either a special share or mirror share in REA.

The REA method is effective on three levels - in countries where there are restrictions on foreign ownership of real estate, for customers who wish to remain anonymous, and anybody else wishing to enjoy the benefits of tax shelters.

Entrepreneurs who are interested in selling real estate via the REA will find a larger potential group of customers than their competitors who are not aware of these advantages. These target customers may be one of three categories -

A. Foreign citizens who are not permitted to buy real estate in a certain country,
B. investors who wish to remain anonymous and not reveal the fact that they own real estate or have the means to buy it, and finally
C. anybody that does not like to share his profit with the Treasury.

An entrepreneur who is marketing real estate via the REA should approach target customers in foreign countries offering property, which is restricted by the local law to foreigners. The entrepreneur may approach target customers who probably prefer to remain anonymous and not reveal the nature of their finances and the existence of their assets. Finally, the entrepreneur should approach the general public and offer a tax shelter in the form of real estate.

The ultimate customer is a wealthy foreigner, and he should be the main target of the marketing efforts.

Chapter 7 Selling Land via Barter

7.1 Direct and Indirect Exchange (Barter)

Land is usually sold in exchange for currency, the price being determined by the terms of the local valuta.[226] Barter transactions are popular in the marketing of goods. The reciprocal trade is a form of international barter.

Many countries stipulate that their purchase of merchandise or services overseas must match by the purchase of local goods in order to maintain the balance in their foreign currency reserves. Large corporations are frequently awarded tenders on the condition that they will purchase other goods by the barter system, even if the purchaser does not need those goods. The corporation is in turn offered a better price for the goods than would be offered to another party.

In Israel, in the 1970's, a barter market developed for land slotted strictly for construction. The increase in the price of land coupled with high taxes imposed upon capital gains prevented the owners of land from selling their land. They found the solution in barter transactions. The owners sold part of their land to building contractors who did not pay for their part of the land with currency but by

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226 In Israel it is customary to determine the price of land in American dollars, and the payment is transacted in New Israeli Shekels according to the representative exchange rate of the dollar on the day of the payment in part or in full. In the appraisal of land, the value is determined in U.S. dollars as a result of the inflation during the 1980's in order to reflect an absolute value of the real estate.

executing the construction on the entire plot. The building was then divided between the former owner of the land and the contractor.

The ratio between the part belonging to the owner and the part belonging to the contractor is influenced by the contribution of each party. The owner of the land contributes the market value of the land with regard to the exchange of currency, and the contractor contributes the cost of the construction, which includes the profit that he is asking for himself.

Nowadays this barter custom has manifested itself and there are barter transactions such as this applied to land deals which comprise hundreds of thousands of square meters slotted for the construction of hundreds of apartments and thousands of square meters of commercial sites.

7.2 Barter in Land

In an agreement regarding the sale of land in exchange for currency, the payment is usually in exchange for the transfer of the fee simple title[227] from the name of the seller to the name of the purchaser. In certain European countries,[228] the fee simple title is transferred in the offices of a public notary, and later registered in the land public records. In these cases the full price is usually paid at the time of the signing of the notarized sale agreement. In other countries,[229] the fee simple title is transferred to the purchaser at the time of registration in the land public records. In this case, the notary holds the payment as a deposit until the time of registration.

In Israel, there isn't a notary deed. The sale agreement is signed generally in the office of the attorney, and the registration process takes approximately six months. The purchaser pays an advance at the time the agreement is signed, with the remaining balance due at the time of registration in the land public records.

In an agreement regarding the sale of land by barter exchange, only part of the land is sold. The exchange is the obligation of the contractor to construct a

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227 "Fee simple title" means the full ownership over land without the legal rights of lessee etc.

228 In Poland.

229 In Germany.

building on the common land. Naturally, the issuing of building permits takes several months and the construction takes between 1.5-2 years. Thus, the fulfilling of the obligations of the buyer in a barter transaction does not take place within a few months, as in a currency payment transaction. The part of the land that was sold to the purchaser is transferred in the land public records only upon "full payment of the exchange" i.e. upon completion of the construction process.

7.3 Financing Advantages in a Land Barter

There are a number of advantages in the selling of a plot of land by barter as opposed to the sale by currency. We shall assume that two adjacent plots of land are up for sale, and it is possible to build on each one an office building of a size of 1,000 m^2. The market value of each is US $1,000,000. The owner of plot "A" is interested in selling the plot by a currency transaction and purchasing offices for the purpose of leasing. The owner of plot "B" is interested in selling his plot by a barter deal. The expected period of time for the building permits and the completion of construction of the building is approximately three years.

Purchaser "A" who will purchase plot "A" with currency must pay the whole price within a few months, and he will also have to finance the cost of the purchase by means of interest payments. With the assumption that purchaser "A" will sell the offices in the building during the construction period, the financing of the purchase price will be US $1,000,000 for an average period of a year and a half. We will assume that the interest will be 6.5% per annum; i.e. 10% for the period of 1.5 years,[230] so the cost of financing the purchase for one year only is US $100,000.

Purchaser "B" who will purchase plot "B" by means of a barter deal, will "pay" via the construction on the part of the plot remaining in the ownership of the seller, and this payment will be spread out over approximately three years. Purchaser "B" will also sell the offices being built during the construction period, essentially he will not have to finance the cost of the purchase of the land at all.

The result is that in a land barter transaction seller "B" can ask 10% more than

230 In the calculation of the interest for longer than one year, one must take into consideration the principal, which one owes interest on the accumulated interest for the first year.

seller "A" in a currency transaction. Purchaser "B", who agrees to pay the additional 10% will have the same total cost as purchaser "A" and he will be exempt from giving the financing bank securities and guarantees which are demanded of purchaser "A".

7.4 Tax Advantages in a Land Barter

As stated, seller "A" sells all of his land at a price of $1,000,000, and we shall assume that the capital gains tax owing as a result of this sale reaches approximately $300,000.[231] Purchaser "A" purchases the fee simple title of the land and must pay a purchase tax[232] at a rate of 5%, in other words $50,000.[233]

If we assume that in the barter transaction only half the plot is sold,[234] the tax will be imposed upon capital gains from seller "B" on $150,000[235] and the purchase tax of the purchaser will only be $25,000. These savings of 50% of the taxes imposed upon seller "B" and purchaser "B" is valid also regarding the retainer fees of the attorney, the notary, and the real estate agent if the transaction is made through this agent.

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231 In Israel, the Capital Gains Tax owing from the sale of real property is somewhere between 12% and 50%, depending upon the year in which the seller purchased. In other countries there are different tax rates, and sometimes there is no capital gains tax at all on the sale of real property if the seller sold it at least 5 years after it was purchased.

232 In some countries there is a Stamp Tax instead of a Purchase Tax.

233 In certain countries, the Purchase Tax or Stamp Tax can reach 7%. Sometimes it is progressive, meaning that the tax rate increases according to the price of the deal, and sometimes it is regressive, meaning that the tax rate decreases according to the price of the deal.

234 The portion of the plot being sold is determined according to the relation between a sale in currency and the cost of the construction. When the value of the plot is the same as that of the cost of construction, the barter transaction will be a sale of approx. 50% of the plot, in exchange for the construction works. If the value of the plot is half of the cost of the construction, 2/3 of the plot will be sold in exchange for the construction on the remaining 1/3.

235 This method was developed in Israel in the seventies.

7.4.1 Sophisticated Barter (Type B)

The structure of said barter transaction is the basic structure, and can be ratified in the following way.[236] We shall assume that seller "C" does not want purchaser "C" to construct the building in the interior of the building; i.e. the air conditioning, acoustic ceilings, the carpets, the carpentry, etc., hereinafter: "interior parts."[237] Seller "C" is interested only in the construction of the outer shell of the building including the building skeleton, the outer coating of the building, the elevators and all remaining components included with the common utilities of the building.

The cost of the construction of the structure of the building and the common utilities, hereinafter: "structure," reaches approximately 60% of the entire cost. If we assume that the total cost of construction is \$1,000 per m^2, then the cost of the construction of the structure and common utilities is \$600. The purchaser will pay the remaining construction costs of \$400 to the other contractors upon construction of the interior parts.

In a case such as this, seller "C" will have two principal ways to execute the deal at his disposal.

A. To sell to purchaser "C" 37.5% of the plot in a barter transaction, whereby he receives a lesser exchange (construction value of \$600 instead of \$1,000), and to finance the construction of the interior parts by means of a loan.

B. To sell to purchaser "C" 37.5% of the plot in a barter transaction, and the remaining 12.5% of the plot, including the building, in a currency transaction to another purchaser. The payment for the remaining 12.5% will finance the construction of the remainder of the building.

The end result will be that the remaining construction costs for seller "C" is \$1,000 per m^2 divided into two types - \$600 per m^2 for the construction and \$400 per m^2 for the interior parts.

In this type of break down of construction costs, the depreciation rate that can be claimed as a deductible expense for income tax purposes has a significant factor. It

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236 This method was developed in Israel in the nineties.

237 On the part of the building remaining in his possession.

can be taken advantage of with regard to the income that the seller will receive from the rental fees of the offices built on the remainder of the plot that he owns.

The annual depreciation rate of a building in Israel reaches 2% and in certain circumstances 4%.[238] As stated, a building of 1,000 m^2 can be built on the plot. In other words, the portion belonging to the seller is 500 m^2· The inclusive building costs of this 500 m^2 are $400 per m^2, with a total cost of $200,000. The yearly depreciation rate of the construction supplemental ranges between 7% and 20%, with an average of 12%.

The result is that the yearly depreciation for this sum of $200,000 is approximately $24,000 instead of a yearly depreciation of $5,000 in a B type barter transaction in which the seller "B" asks of purchaser "B" the construction of the whole building including the interior parts. The difference of $19,000 is a deductible expense, and can be utilized against rental fees.[239]

7.5 Cash Flow and Tax Shelters in the Sophisticated Barter

In order to stress the advantages of the sophisticated barter (type B) I will compare it to the sale by currency of the same plot, and to a simple barter.

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[238] In most countries the yearly depreciation rate is very similar.

[239] With the depreciation of all the costs of the construction supplemental within approximately 8 years, the tables will be turned and the sum of the yearly costs of the more sophisticated barter deal will be lower than in a "regular" barter transaction. In the end, the nominal amount will balance out. The hidden profit is in the postponement of income tax payments on the profit earned from the lease of the building, and this can be measured in terms of the cost of financing the difference in taxes.

A. A simple sell - Seller "A" sells plot in exchange for $1,000,000 in currency and purchases offices

The exchange for the sale minus capital gains tax and purchase tax

The exchange for the sale	1,000,000
Minus capital gains tax at a average rate of 30%	- 300,000
Balance after taxes	700,000
Minus purchase tax of 5% for purchasing other offices	- 33,000
Balance for the purchase of other offices	667,000

Annual rental income

Area of the offices which can be purchased at a cost of $2,000 per m^2	m^2 333
Yearly rental income per m^2 at a rate of 10% of investment returns	x 200
Annual rental income	66,000

Annual depreciation allowed as expenses

Area in meters	m^2 333	
Cost of construction per square meter	x 1,000	
Annual depreciation rate	x 4%	
Amount of expense allowed for depreciation (rounded off)		- 13,300
Profit to be taxed		53,300
Income tax rate		x 50%
Amount of income tax		26,650

Annual cash flow after payment of income tax

Cash flow of rental income	66,000
Minus income tax payments	- 26,650
Annual cash-flow	39,950

B. A simple barter - Seller "B" sells 50% of the plot in a barter transaction and receives in exchange 500 m^2 of offices plus 10% in currency for the financing savings of the purchaser

The exchange for the sale (for tax assessment purposes)

Area of offices received in the barter transaction		m^2 500
Construction costs of $1,000 per m^2		x 1,000
Total construction costs		500,000
Plus 10% in currency for finance savings		+ 50,000
Total sum owing in capital gains taxes		550,000

Capital gains tax and cash flow

Amount of capital gains tax according to average rate of 30%		165,000
Minus portion paid in currency received in the sale		- 50,000
Cash flow debit		115,000
Interest for the average period of one and a half years until		
Completion of construction	x 10%	
Plus interest costs		+ 11,500
Total cash flow debit for date of building completion		126,500

Annual rental income for offices

Area of the offices received by the seller		m^2 500
Annual rental income per m^2 according to 10% equity yield		x 200
Annual rental income		100,000

Annual depreciation allowed as expenses

Area in meters	m^2 500	
Cost per square meter	x 1,000	
Annual depreciation rate	x 4%	
Minus amount of expenses allowed for depreciation (rounded off)		- 20,000
Profit to be taxed		80,000
Income tax rate		x 50%
Amount of income tax		40,000

Annual cash flow after income tax

Cash flow of rental income in first year		100,000
Minus income tax payments		- 40,000
Annual cash-flow		60,000

Financing of cash flow debit

First year

Rental income in first year after income tax		60,000
Minus cash flow debit at date of building completion		- 126,500
Balance of cash flow debit after first year		- 66,500
Financing of cash flow debit with interest of 6.5%	x 6.5%	
Cost of financing (rounded off)		- 4,300
Total deficit in cash flow at end of first year		- 70,800

Second year

Total deficit in cash flow at end of first year		- 70,800
Rental income in second year after income tax		60,000
Balance of cash flow debit after second year		- 10,800
Financing of cash flow debit at a rate of 6.5%	x 6.5%	
Cost of financing (rounded off)		- 700
Total deficit in cash flow at end of second year		- 11,500

Third year

Total deficit in cash flow at end of second year		- 11,500
Rental income in third year after income tax		60,000
Balance of cash flow at end of third year		48,500

C. A sophisticated barter - Seller "C" sells 50% of the land in a barter transaction and receives 500 m^2 of offices (structure only) at a cost of $600 plus $400 for every m^2 in currency, and an additional 10% in currency for the financing savings of the purchaser, and pays back $400 for completing the construction

The exchange for the sale (for calculated tax purposes)

Office area received in barter	m^2 500
Construction costs of $600 per m^2	x 600
Total construction costs	300,000
Plus $400 per m^2 in currency	200,000
Plus 10% payment in currency for savings in finance	50,000
Total exchange due to capital gains tax	550,000

Capital gains tax and cash flow

Amount of capital gains tax at an average rate of 30%		165,000
Minus portion paid in currency received in the sale		- 50,000
Cash flow debit		115,000
Interest for period of a year and a half to completion of construction	x 10%	
Minus interest costs		- 11,500
Total cash flow debit at date of completion of construction		126,500

Annual rental income for offices

Area of offices received by the seller	m^2 500
Annual rental income per m^2 as per 10% equity yield	x 200
Annual rental income	100,000

Annual depreciation allowable for expenses

Area in meters	m^2 500		
Cost per m^2	x 600		
Depreciation rate of the structure	x 4%		
Amount of expenses allowed for depreciation (rounded off)		12,000	
Area in meters	m^2 500		
Cost per m^2	x 400		
Depreciation rate of the interior parts	x 12%		
Amount of expenses allowed for depreciation (rounded off)		24,000	
Minus total amount of expenses allowable for the duration of first 8 years			- 36,000
Profit owing income tax for the duration of first 8 years			64,000

Income tax rate		x 50%
Amount of income tax for duration of first 8 years		32,000

Annual cash flow after income tax

Cash flow of rental income in first year		100,000
Minus income tax payments		- 32,000
Yearly cash-flow		68,000

Financing of cash flow debit

First year

Cash flow of rental income minus income tax		68,000
Minus cash flow debit at date of completion of construction		- 126,500
Balance of cash flow debit after first year		- 57,500
Financing of cash flow debit with interest of 6.5%	x 6.5%	
Financing costs (rounded off)		- 3,700
Total deficit in cash flow at end of first year		- 61,200

Second year

Total deficit in cash flow at end of first year		- 61,200
Rental income in second year after income tax		68,000
Balance of positive cash flow after second year		6,800

Profit of financing of accelerated depreciation

Annual income tax paid by seller "B"		40,000
Annual income tax paid by seller "C" in first eight years		- 32,000
Difference in positive cash flow between seller "B" and "C" per annum		8,000
Annual financing costs		x 6.5%
Annual profit from postponement of income tax payments		520
Multiplied by 8 years		x 8
Total linear profit		4,160
Profit by interest derived (rounded off)	5,000	

Summary

	DEAL "A" Exchange for currency	**DEAL "B"** Exchange for simple barter	**DEAL"C"** Exchange for sophisticated barter
Tax savings compared to seller "A"	**Zero**	**168,000**	**168,000**
Savings in cost of financing	**Zero**	**Zero**	**5,000**
Annual cash flow after income tax	**39,950**	**60,000**	**68,000** **(First 8 years on average)**
Value of offices after compulsory **Payments and financing**	**333 x 2000 =** **666,000**	**500 x 2000 =** **1,000,000**	**500 x 2000 =** **1,000,000**

7.6 Marketing Methods for Land via Barter

In this chapter I have presented three methods for the sale of a plot that is designated for offices. I analyzed the differences between a sale via the exchange of currency (deal "A") and a sale via a barter method, in which the seller sells only part of the plot and receives in exchange construction services on that part of the plot which remains in his possession. In deal "B", the seller orders the construction of the offices according to complete specifications, and in deal "C", the seller orders the construction of the structure only, and completes the construction of the interior parts himself.

In comparison to seller "A", seller "B" saves the capital gains tax on that portion of the plot which he does not sell, as well as the purchase tax for the offices which he is not required to buy. In comparison to seller "A", seller "C" also enjoys the same benefits as seller "B".

In comparison to seller "B", seller "C" enjoys a better cash flow during the rental period of his offices, as well as the benefit of the savings of interest costs resulting from the increase in depreciation and postponement of income tax payments.

In comparison to buyer "A", buyer "B" saves the purchase tax on that portion of the plot that he does not buy as well as the benefit of the savings of interest costs on the invested money he should pay for the plot. In comparison to buyer "A", buyer "C" also enjoys the same benefits as buyer "B".

The same example can be applied regarding the sale of a plot designated for the construction of apartments. The additional benefit, which the seller may enjoy from the barter method, will result from the selling of an apartment for which he may be exempt from capital gains tax, whereas the sale of the whole plot will require him to pay capital gains tax.[240]

Landowners wishing to sell via the barter method should focus their marketing efforts on contractors and entrepreneurs who do not have the resources required for the purchase of an expensive plot, or do not have the means to receive the necessary financing. The marketing strategy should emphasize the fact that the buyer has no need for personal equity in order to purchase said plot. The target customers will be building contractors and entrepreneurs with good reputations in the business and abundant experience in construction, but who lack the necessary cash flow.

Building contractors and entrepreneurs, who are interested in purchasing land via the barter method, will be more successful than their competitors who are not aware of the advantages pointed out above. Their marketing strategy aimed at the landowner should emphasize the benefits of the landowner in the savings of capital gains tax, as well as the larger building area they will own. In a barter deal the buyer is able to offer more value in exchange than a buyer who offers a sale in currency, because he saves the costs of financing which the investment requires to purchase the plot.

The entrepreneur interested in the purchase of land by the barter method, where the land is not readily available for construction, should market his entrepreneurial services by pointing out that the seller need not approach a large number of other

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[240] The barter method for selling a plot has been developed in Israel. I have not found this method implemented in other countries. This method can be effective and popular in countries where there is a capital gains tax imposed at a significant rate on the sale of land.

professionals. These Professionals include the civil engineer who will prepare the plans to enable construction, the architect who must plan the design of the buildings, a land surveyor to measure the land so the land can be registered, the lawyer to oversee the procedures necessary to release the land from the authorities, and the contractor who will carry out the construction works after the land is available for construction. In addition, the entrepreneur should emphasize the tax savings to which the landowner is entitled to the barter method.

7.7 Marketing Real Estate via Barter and REA

When a landowner sells only a portion of a plot of land via barter, the deal stipulates that in exchange he will receive construction services on the plot that remains in his possession. It is the REA that intervenes to break down the deal into manageable bites; i.e. the sale of the land, the construction of a building on that land, or construction of only a portion of a building. The completion of construction of the building is also done by a deal engineered by the REA.

The REA becomes, therefore, the agent who exists specifically and exclusively for the marketing of the tax shelter, not the marketing of real estate. Ergo, the REA will deal only with those transactions that will produce and enjoy tax shelters.

Why should a seller of a portion of a plot pay capital gains tax and purchase tax for a portion of land if the deal can be engineered by the REA to avoid these unnecessary payments? The REA is, therefore, also marketing a better cash flow and the savings of interest costs that will result from the postponement of income tax payments.

The REA will also market the savings that are to be enjoyed by the sale of one plot of land designated for the construction of two private apartment dwellings. The deal will be arranged by the REA so that the landowner is exempt from capital gains tax, whereas the sale of the whole property will require the payment of taxes.

These sophisticated manipulations of the tax laws regarding the purchase and sale of real estate assets, which will be engineered by the REA, were developed in Israel and are not to be found in other countries. The REA is able to function and succeed in this pursuit because most contractors and land entrepreneurs are not aware of these advantages. The REA can engineer deals between landowners and buyers where the cash flow situation does not enable the buyer to invest personal equity in the purchase of expensive lands, or do not have the means to be eligible for financing necessary for the purchase.

The REA will market land for sale by emphasizing the fact that with the help of their services there is no need for personal equity in order to purchase this land. The target customer will be building contractors with a good reputation in the building industry who have no operating capital, but who do have a great deal of experience in construction.

Other target customers for the REA are landowners in possession of lands that are readily available for construction. These lands will be marketed by the REA by virtue of the savings in taxes and significant exchange that the target seller is entitled to. The REA can offer more than a contractor who can only offer the limited savings of the costs of financing which the investment requires to purchase the land.

If a plot of land is not readily available for construction, it may not be advisable for the REA to get involved with this particular plot. The savings in taxes will probably not justify the costs and headaches necessary in order to make the land available for construction.

Chapter 8 Conclusions

In the introduction, I have mentioned the importance of the equilibrium between the needs of the community that imposes compulsory payments on the taxpayers versus the sacredness of the private property in this era.

A tax imposed on the profit of land and buildings i.e. income tax, capital gains tax, V.A.T., as well as purchase tax and selling tax create a gap between what a seller receives and what a buyer pays. The tax rates affect the equilibrium point.[241]

Economists and philosophers[242] argue about this issue of the equilibrium point since the industrial revolution up to today. There is no consensus whether the landowner should carry the main burden of the tax in order to exempt the labour from heavy taxation, or should this burden be shared between the landowner the entrepreneur and the working class.

One should be aware that up until the 19th century, the term "landowner" meant a

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241 Most countries raise resources through a variety of taxes, including direct taxes on wage and property income, contributions to trust funds, and a variety of indirect taxes on goods, either at the final point of sale or on the inputs used to make them. A smaller amount of revenue is raised from taxes on property, on capital gains, and on capital transfers, particularly at death. Most countries have a separate corporate income tax. Government budget, Problems of public expenditure control, Encyclopædia Britannica, Britannica.com editors, http://www.britannica.com/eb/article?eu=109165&tocid=26337#26337.toc

242 Adam Smith, Thomas Malthus, David Ricardo, Karl Marx, Frederick Engels, Alfred Marshall, Joseph Schumpeter and others.

landlord of a vast rural land, i.e. king, duke, or count, as a result of the feudal economic system. The peasants under this regime were vassals with no property and no civil rights. Books, essays and article writers in the 19th century faced the creation of a new class - the "city vassal", which means an industrial working class with no social rights such as the vassal class under the feudal regime. No wonder economists and philosophers tried to protect this unprotected class. Hence, the socialism grew from the sorrow and grief of the working classes in the 19th century.

We live in a capitalistic era. It is common to describe the earliest stages of capitalism as mercantilism, the word denoting the central importance of the merchant overseas traders who rose to prominence in 17th and 18th century England, Germany, and the Low Countries.[243]

In the 20th century especially after the Second World War the term landowner meant a person or a corporation that owns real estate mostly located in cities. The concept that the landowner should carry the main burden of the tax in order to exempt the labour from heavy taxation weakened since the working classes achieved labour organizations, social rights, and equal civil rights in the state as all other classes.[244]

The perpetual immigration of the population from the country to cities created the mega cities in the 20th century. The decline of the status of the landlord occurred during the last two centuries, because the rural land lost its unique political and economic value of feeding the population and ceased being the main source of wealth. The land in the cities gained its high value for industry, merchant,

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243 "Mercantilism" - economic theory and practice common in Europe from the 16th to the 18th century that promoted governmental regulation of a nation's economy for the purpose of augmenting state power at the expense of rival national powers. Encyclopædia Britannica, Britannica.com editors, http://www.britannica.com/eb/article?eu=53378&tocid=0

244 The debate around the relative roles of markets versus bureaucrats took on renewed life with the end of the Cold War. The public policy debate shifted from focusing on the public sector to emphasizing markets and their ability to innovate, decentralize, use incentives and meet needs more effectively. Yet there remains in this public policy debate a stunning silence about the absence of property rights for the rural poor. Bryant, Coralie. Property rights for the rural poor: The challenge of landlessness, in Magazine: Journal of International Affairs, Fall 1998. http://www.euforic.org/rondzend/nov98_2.htm

entertainment, and dwelling.

There is no known civilization that has not taxed its people, and there is a relationship between tax rates and revenues.[245] Nowadays, the taxation system and the land taxation in particular, has a main impact on the wealth of the nation and the welfare of the people. The increasing value of the land in the cities shifted the taxation from the rural land to land and buildings in the city. The modern

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[245] In deciding how to raise enough money to finance its expenditure program, a government faces a large number of different considerations. First, the tax system is complex, containing many different taxes, each often having a complex structure. Perhaps the major consideration is the effects on behaviour that particular tax rates will cause.

Income tax has a graduated structure whereby no tax is paid on the first segment of income and then each subsequent segment is taxed at a higher rate than the previous one. In the United Kingdom, most taxpayers pay tax at a uniform marginal rate, while other countries have more steeply rising rate schedules. Higher marginal tax rates make work less rewarding, which tends to reduce work effort. High marginal rates, however, may have less impact in some areas than others, a factor that needs to be considered when deciding who should bear the tax burden. Such considerations presumably have influenced the trend in many countries to tax the wealthiest groups.

Whatever the structure of the tax, the general proposition that increasing tax rates will reduce work effort usually holds; and this, in turn, tends to reduce tax revenue again. A vigorous debate has persisted over the "Laffer curve," which postulates that at some level of tax the disincentive effects will be so great as to mean that an increase in tax rates actually reduces revenue. This idea has been influential in leading governments to attempt to curtail the share of public expenditure in national income. The administration of Ronald W. Reagan in the United States cut taxes in 1981 in the hope of increasing revenue by stimulating the economy, and, while this succeeded to some extent, expenditures grew even more, causing a substantial increase in the budget deficit. Tax rates affect the pattern and level of consumption. Excise duties, value-added tax, and sales taxes all change the relative prices of goods and the attractiveness of consumption relative to saving. Once again, an increase in tax rates will generate responses that tend to cause a reduction in revenue, and, again, governments must balance the strength of these effects when deciding on which rates to increase. Other considerations, such as the protection of domestic industries, also affect such decisions.

Tax rates also affect commercial decisions, and the balance between individual and corporate taxes must reflect this. Accordingly, many countries have sought to attract new manufacturing industry with tax concessions. Finally, as rates rise, taxpayers seek more ways to avoid taxes. They employ tax advisers to find more tax-efficient routes, which, in particular, can involve a search for capital rather than income-yielding assets and the movement of activities overseas to less heavily taxed countries. "Mercantilism", Encyclopædia Britannica, Britannica.com editors, http://www.britannica.com/eb/article?eu=53378&tocid=0

administrating techniques and creativity of the modern rulers invented various compulsory payments imposed directly and indirectly on the real estate owners and users.

This growing participation of the state and the local authorities in the private property of the landowners affects the equilibrium between the community and the taxpayers and creates a need for a sophisticated tax haven (tax shelters).

The legislators and the tax officers weave a dense net of taxation in order to capture most of the economic benefits of the landowners from their property. Hence, the landowners persist to discover loopholes in this dense net in order to create a legal tax-free profit.

There is another way to create a legal tax-free profit. Taxpayers create political and social lobbies in order to put pressure on the legislator. The most popular political party is the one that initiates tax-exempts and discounts that create a legal tax-free profit. It effects the sovereignty of the parliaments and puts a limit on the appetite of the governments for higher taxes.

Learning the phenomenon of taxation of the various profits of real estate together with the modern attitudes to the capitalistic economy in democratic regimes is the key to the modern trends of owning property, selling and buying, renting and leasing, administrating and marketing.

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Table A - World Population: 1950-2050

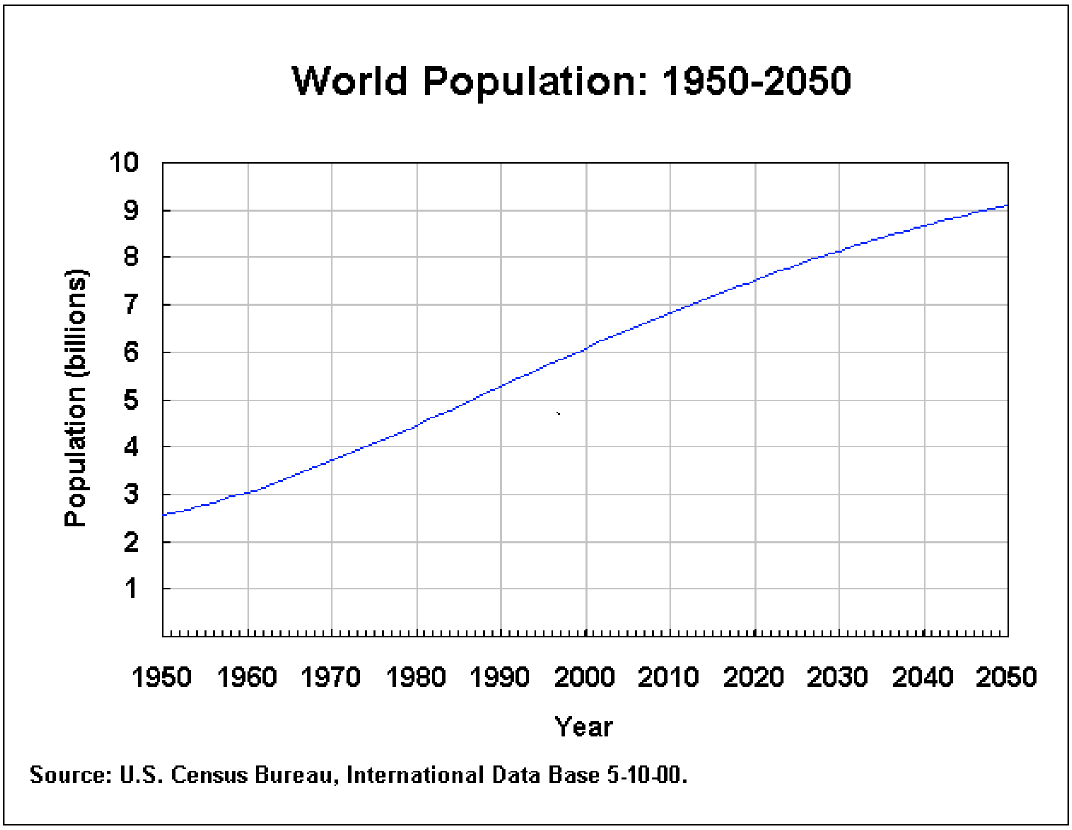

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Table B - Historical Estimates of World Population

Population in millions.[246] When lower and upper estimates are the same they are shown under "Lower."

Year	Summary Lower	Summary Upper	Biraben	Durand Lower	Durand Upper	Haub	McEvedy and Jones	Thomlinson Lower	Thomlinson Upper	UN, 1973 Lower	UN, 1973 Upper	UN, 1995	USBC
-10000	1	10					4	1	10				
-8000	5					5							
-6500	5	10								5	10		
-5000	5	20					5	5	20				
-4000	7						7						
-3000	14						14						
-2000	27						27						
-1000	50						50						
-500	100						100						
-400	162		162										
-200	150	231	231				150						
1	170	400	255	270	330	300	170	200		200	400	300	
200	190	256	256				190						
400	190	206	206				190						
500	190	206	206				190						
600	200	206	206				200						
700	207	210	207				210						
800	220	224	224				220						
900	226	240	226				240						
1000	254	345	254	275	345		265					310	
1100	301	320	301				320						
1200	360	450	400			450	360						
1250	400	416	416									400	
1300	360	432	432				360	400					
1340	443		443										
1400	350	374	374				350						
1500	425	540	460	440	540		425					500	
1600	545	579	579				545						
1650	470	545				500	545	500		470	545		
1700	600	679	679				610	600					
1750	629	961	770	735	805	795	720	700		629	961	790	
1800	813	1,125	954				900	900		813	1,125	980	
1850	1,128	1,402	1,241			1,265	1,200	1,200		1,128	1,402	1,260	
1900	1,550	1,762	1,633	1,650	1,710	1,656	1,625	1,600		1,550	1,762	1,650	
1910	1,750											1,750	
1920	1,860											1,860	
1930	2,070											2,070	
1940	2,300											2,300	
1950	2,400	2,556	2,527			2,516	2,500	2,400		2,486		2,520	2,556

246 http://www.census.gov/ipc/www/worldhis.html

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247 gopher://gopher.undp.org:70/00/ungophers/popin/wdtrends/histor

248 http://www.census.gov/ipc/www/worldpop.html

Appendix of Pictures

1. The map of Sumer

2. Ziggurat - the Temple of Sumer