Promoters versus parasites

Art dealers, auction houses, and the contested potential of art as an investment

Olav Velthuis
Visiting Scholar
ISERP
Columbia University
New York

Email ov2102@columbia.edu

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Introduction

This paper investigates the performance of art as an investment good. In doing so, the paper diverges from the extensive literature in cultural economics, which has compared the rate of return on investing in art to rate of returns on 'ordinary' portfolio's consisting of stocks and bonds. The main aim of the paper is twofold: first of all, to contrast the behavior of dealers on the primary market for art, and auction houses on the secondary market. I show that the activities of auction houses are by and large limited to matching supply and demand, while focusing on single works of art rather than artist's careers; art dealers on the primary market, by contrast, are invested in establishing a market for an artist; they develop long term relationships with the artists they represent, and actively promote their careers. I argue that the dealer's pricing decision on the primary market, which serves to lend structure to the market, is part of this attempt to establish a solid market. Also, by trying to control the 'biography' of artworks that leave their gallery, dealers seek to limit the possibility of future resale, and thereby the potential of investing in art. Paradoxically, they aim at establishing a market by limiting rather than enhancing its liquidity.

The second aim of the paper is to provide a tentative explanation for the existence of price differences between the primary and the secondary segments of the art market. From an economic perspective, it is expected that the price level for similar works by the same artist should be roughly equal at auction and in the gallery. If a difference in price occurs between both market segments, rational actors instantaneously respond by arbitrage. This process of 'buying cheap and selling dear' continues until auction and gallery prices end up at the same level. Nevertheless, empirical research has shown that price differences are endemic on the art market. I argue that auction and gallery prices not only differ in quantitative, but also in qualitative respect; these qualitative, substantive differences between gallery and auction prices partially prevent arbitrage from taking place, and produce price stickiness; thus, a so-called price dispersion equilibrium may emerge.

1. Methods

This paper is based on qualitative empirical evidence. By providing a thick, ethnographic description, I study the market for contemporary art in social, cultural, and institutional detail. Between and April 1998 and March 2001, I conducted 18 semi-structured, in depth interviews with art dealers in Amsterdam, and 18 interviews with contemporary art dealers in New York. In both cities, the same questionnaire was used. The interviews lasted 45 minutes to an hour on

average. Two pilot interviews were conducted to test the questionnaire. The interviews lasted 45 minutes to an hour on average. In spite of the fact that interviews have been conducted in two art capitals whose size and institutional parameters differ considerably, the emphasis of this paper will be on similarities rather than differences between the art market in both cities.

The selection of galleries was made on the basis of two criteria: given the enormous diversity of galleries or the lack of homogeneity in the gallery population, it was impossible to create a representative sample in terms of probability. Instead, diversity in terms of age and location of the galleries was maximized. Secondly the sample was partially based on a snowball method since interviews with some dealers were made on the basis of recommendation of gallery owners I had interviewed before (Arber 1993, p. 73-74) – previous art market research indicates that especially access to prestigious dealers can only be gained via recommendations (Warchol 1992). In order to avoid remaining in one gallery network, I never used more than one recommendation a gallery would give me.

Transcripts of the interviews have been coded (in the text 'NL' refers to Amsterdam art dealers and 'US' to New York dealers). Furthermore, I conducted many informal conversations with dealers and in some cases with artists and collectors at openings, parties, professional meetings, art fairs or public debates; especially during longer visits to dealers who provided me access to their archive, data were gathered by means of non-participant observation. Fieldnotes were made of these conversations and observations, but no explicit references will be made to them. Both to triangulate my data and to supplement them, the paper is also based on written material from eclectic sources such as reviews in art magazines, interviews with artists, collectors or gallery owners published in books and magazines, biographies of art dealers and guidebooks to the art market for artists. Nevertheless, given the qualitative nature of my findings, the study has a largely explorative character. Further quantitative research needs to be conducted to lend systematic support to the findings I present.

2. Economic explanations

The motive for buying art which economists have been almost exclusively concerned with, is financial speculation. The assumption is that art is a financial asset, which functions as a store of value, and can be resold at a later point in time against a higher price. The question that has intrigued economic analysis is whether these speculative motives for buying art are warranted. In order to answer that question, economists have constructed so-called annual or semi-annual price indexes for paintings and prints, over a period ranging from 15 (Pesando 1993) to 200 (Buelens and Ginsburgh 1993), or even 300 years (Baumol 1986). The findings of these studies is that the rate of return on traditional investment portfolios composed of stocks and bonds,

exceeds the rate of return on paintings in the long run. No consensus exists, however, on the exact magnitude of the difference (for an overview, see Frey and Eichenberger 1995).

The fact that returns on paintings are lower than on other investments, can be interpreted in two different ways: first of all, it may mean that the art market is inefficient as a market for financial assets (Pesando 1993). William Baumol, for instance, argued in a widely cited article on *Unnatural Value: or Art Investment as a Floating Crap Game*, that market values of artworks "will exhibit random behavior", "float aimlessly", and show "unpredictable oscillations" (Baumol 1986, p. 10). The second, more likely interpretation is that art is bought for other than just speculative reasons. Since buyers of art, like other economic agents, are maximizing utility, some other, non-monetary revenue must have compensated the lower rate of return on their investments in art: they derive utility from looking at the painting. In this interpretation, the difference in return between investing in art or in other financial assets becomes a measure of the aesthetic utility that paintings yield on top of their monetary returns.[1] As John Picard Stein put it: "Any superior performance derivable from paintings can be attributed entirely to the viewing pleasure they provide, not capturable by speculators" (Stein 1977, p. 1035; Fase 1996).

The primary market for art, where contemporary artworks appear on the market for the first time, has largely been ignored within cultural economics, most likely because of the limited availability of data (for exceptions, see Rengers and Velthuis 2002; Sagot-Duvauroux, Pflieger et al. 1992; Santagata 1995). However, the primary market deserves special attention for a number of reasons. First of all, like the market for securities, the art market is structured in terms of a primary and a secondary market segment. Unlike in financial markets, where most of the securities issued on the primary market can subsequently be traded on the secondary market, the vast majority of artworks sold on the primary market do not have a resale market.[2] In other words, the auction prices studied by economists represent only a small selection of the artworks that have originally been sold on the primary market. Secondly, since 1998 auction house Christie's has organized auctions for artworks made by artists whose work is also available on the primary market, thus increasing the liquidity of contemporary art. Quantitative studies focusing on the rate of return on buying contemporary art on the primary market, and selling on the secondary market have so far not been conducted. Nevertheless, auctions like those of the so-called Peau de l'Ours collection in 1914 (see Gee 1981), the Scull collection in 1973 (see Haden-Guest 1996), or the Ganz collection in 1997 (Landes), have attracted considerable

[1] Stein defines the efficiency of an asset as "the difference between its observed return over a specified time period and the return that could have been expected ex ante on an alternative, naively constructed portfolio" (Stein 1977 p. 1028).

attention. In each case, the rate of return on the collection that was largely composed of contemporary artworks bought on the primary market, easily surpassed the rate of return on a portfolio of securities. In order to understand how contemporary art functions as an investment object, the structure of the art market needs to be taken into account. Third, the deliberate attempts of primary market dealers to reduce rather than enhance the liquidity of the works they sell, as well as the opposition they construct between their (promoter's) prices and the (parasitic) prices of auction houses, are sociological phenomena that deserve attention in their own right. Also, they may cast a different light on economic behavior on the primary and the secondary market for securities.

3. Establishing a market

Auctions long served as a wholesale market for dealers in Western Europe and the United States in the first half of the 20th century. At the time, differences between auction and gallery prices were firmly institutionalized: dealers would buy their stock for wholesale prices, while private collectors hardly went to auctions. To make a profit, dealers marked up auction prices in order to establish the gallery price. "It used to be a sort of law, that auction prices were half the gallery price. Therefore dealers could buy at auction" as the owner of an old Dutch gallery explained ($_{NL}$12). In the United States Marquis this institutionalized price difference has been referred to as "the old gentlemanly deal" (Marquis 1991, p. 250).

This structural relation between galleries and auctions changed in the second half of the twentieth century when demand at auctions was exercised by collectors rather than just galleries.[3] Art historian Robert Jensen has argued that when American collectors started buying modern in the early 20th century, they did not do so with "the same speculative intensity found among many of the Parisian *amateurs.* Rarely were major American collections dispersed at auction during the collector's lifetime – or even by his heirs" (Jensen 1994, p. 62). From the 1960s onwards, however, private collectors increasingly started buying and selling at auction and were actively enticed to do so by auction houses. Whereas Christie's had only one representative in the United States in 1959, and Sotheby's only entered in 1961, today it stages many sales a year in nine regional offices. Sales have increased rapidly from about 23 million in both houses in 1958 to several billions today. Since the 1970s, these auctions have increasingly

Kommentar: Veilingomzet US opzoeken

[2] According to one estimate, only 0,5% of the works sold today will still have market value in 30 years (Caplin 1989, p. 242).
[3] Susan Lee, Ronald Bailey and Dana Wechsler, 'Greed is not just for profit', *Forbes* 4.18.1988, p. 65.

paid attention to contemporary art; in 1998, Christie's even started organizing biannual auctions devoted to contemporary art, i.e. made by living artists, exclusively.[4]

This did not mean that structural relations between auctions and dealers were leveled out. A first structural difference concerns social ties between actors on the art market. A defining characteristic of contemporary art galleries is that they have long term relationships with both artists and collectors. They present themselves as patrons of a small number of artists, whose work they sell on a commission basis, and as confidants of collectors. In order to maintain these ties, market transactions between these three parties are infused with gift exchanges (Velthuis 2002). Collectors are granted privileges by dealers, such as invitations to after-opening dinners and parties or buying works at a discount. Artists are granted financial support when they suffer economic hardship, and moral support in the establishment of their careers. Focusing on single works of art rather than artists' careers, auction houses, by contrast, don't have any ties to artists. They maintain only lose ties to a small number of influential collectors, who are actively approached before important auctions in order to raise their interest for specific works coming up for sale (see Watson 1992).

A second structural difference concerns the respective contributions of auction houses and galleries to establishing a market for an artist's work. Auctions were, as Deirdre Robson has argued in her noteworthy monograph *Prestige, Profit and Pleasure*, part of the support system of the Parisian art market in the late nineteenth and early twentieth century; since art dealers bought works directly from artists and kept them in their inventory, they had a direct interest in high auction prices. By contrast American and Dutch art dealers, who sold works of living artists on a commission basis, "were less likely to use auction prices as a promotional tool." (Robson 1995, p. 11). In fact, dealers developed an antagonistic relationship to auctions, since they are not committed to and do not have in interest in the development of the artist's career. Indeed, dealers reproach auction houses for being exclusively profit oriented and for disregarding the long term interests of contemporary artists. In my interviews, auctions were represented as "greedy" (see also Sagot-Duvauroux, Pflieger et al. 1992, p. 96).[5] Says one dealer: "I think the real problem with the secondary market are the auction houses. They are the ones that really conflict with the galleries when it comes to promoting the artists. All [auction houses] do is living off the artist. (…) They may be necessary in another format, but as far as helping the artists, they are really the parasites of the art world. They are just turning it over and making a buck" ($_{US}$8). Another dealer argued even more aggressively: "The role of auction houses is different nowadays. They are more important. They sell more work of young artists. In

[4] See 'Christie's tackle the cutting edge', *The Art Newspaper* no. 80, april 1998; 'Christie's platform jonge kunstenaars', *NRC Handelsblad* 18.4.1998.
[5] Pamela Young, 'Masterpieces and Millions', *Maclean's*, 4.16.1990.

the 1980s Schnabel had himself to blame. He would sit at the auction house and talk to everybody and put himself in the spotlight. But here you have a different story. It is a parasitic culture. Likewise secondary market dealers are bottom feeders. They have no loyalty to the long term integrity of the art world. It think it is disgusting" ($_{US}$18).

Galleries, by contrast, consider it as their main activity to establish a market for the artist's work. This means that they organize exhibitions of an artist's work in order to enhance its visibility, and may publish catalogues which accompany these exhibitions; they actively and permanently approach collectors, seek to 'educate' them, and try to persuade them to acquire work of the artists they represent; more importantly, they seek to establish an artistic reputation by inducing critics to write about the work, and convincing curators to include the work in the exhibitions that are organized in museums and other non-profit venues. In short, art dealers actively contribute in the social construction of the value of an artist's work (see Zolberg 1990). As I will show in the next sections, price setting and reducing rather than enhancing the liquidity for an artist's work, are part of the repertoire that dealers have at their disposal to establish a market.

4. Price differences and different prices

At auction, supply and demand interact directly in order to establish a price. By contrast, gallery prices on the primary market are posted or fixed prices; although some room for negotiation exists in the form of price discounts, the price is fixed before the sale by the dealer.[6] Demand *does* influence the gallery price by inducing price adjustments, but compared to the auction mechanism the influence of demand is indirect.

Apart from being determined directly by supply and demand factors, auction prices differ from gallery prices because of their public character. Major auctions are covered by newspapers and magazines while their prices are publicly available. Social scientists have underscored this public character by calling auctions 'tournaments of value' or 'status contests'. At stake in such tournaments is not just status, rank, fame, or reputation of actors, but also the disposition of the

[6] Only a limited category of goods is sold by auction. Apart from art, antique and other collectibles, auctions exist for financial products (stocks, bonds and derivatives), agricultural products (vegetables, fruit and flowers), and primary metals (cf. Okun 1981, p. 134). Fixed pricing is a relatively recent economic practice; it was only introduced when trade became oriented to an impersonal public in the late eighteenth and nineteenth century (Carrier 1994, p. 373); before prices were commonly set by means of private negotiations. Because of its inertia and limited flexibility in adjusting to changes in supply and demand, fixed pricing corresponds least to economic theory, but in spite of that it is most common in western economies. The economic rationale is, however, that fixed prices economize on information, search and transaction costs. With the steadily rising value of time in western economies, opportunity costs of time consuming auctions have increased, turning the posted price system into the most attractive alternative (Milgrom 1985, p. 261).

‘central tokens of value’ in society (Appadurai 1986, p. 21; cf. Baudrillard 1981).[7] A SoHo art dealer, active on the secondary market, characterized the public nature of auctions as follows: “Millions of people are seeing it; if people really like the work, it goes up and if they don’t like it, it does not. (…) Put it on the block and you do a Miss Popularity contest” ($_{US}$13). By contrast, gallery sales have an exclusive, private character; details of a transaction, including the price, are difficult to find out for outsiders. As Moulin was told in her research on the market for contemporary art in France: “In this business, silence is the first virtue” (Moulin 1967, p. 106).

The public character of auctions and their direct responsiveness to supply and demand makes auction prices a reliable and preferred standard of value for contemporary art. For instance, for the American Internal Revenue Service, auction results tend to carry more weight than private estimates of value, such as expert appraisals or gallery sales of comparable artworks.[8] When modern art developed in early twentieth century Paris, auction sales functioned as an “easily available indicator of taste, helpful for prospective collectors in the face of dealer secrecy” (Robson 1995, p. 8). In 1914, the outstanding collection of a small group of French investors known as *La Peau de l’Ours*, came up at auction at the Parisian Hôtel Drouot. The group had bought new, predominantly cubist artworks by artists such as Picasso before their careers had been established. The success of the auction was perceived by art critics as “a confirmation of the art's importance that their own aesthetic evaluations could not confer” (Fitzgerald 1995, p. 17; Gee 1981, p. 22-23).

Later in the century, New York art dealer Betty Parsons, once famous for promoting artists like Jackson Pollock, Barnett Newman and Mark Rothko, insisted upon distinguishing gallery and auction prices sharply for similar reasons. Whereas a “false value” was expressed by gallery prices, “auctions have become a sort of barometer for pricing art” (Coppet and Jones 1984, 29-30). During the ‘boom’ of the art market in the 1980s, collectors trusted high gallery prices of young artists because they were backed up by equally high auction prices. The former President of the American Art Dealers Association acknowledged the existence of a “symbiotic relationship” between dealers and auction houses: “Prices are really created by the auction houses, by the excitement of various people bidding,. They support us because they support the price level of the market. If I have a painting similar to one sold at auction, I do sell it for more, because a public price has been established.” More recent evidence of the reliability of auction prices is that after the art market had collapsed in the early 1990s, actors on the market regained

[7] Jean Baudrillard argues that auctions are not economic but aristocratic measures of value. Instead of functional economic behavior, an auction is “a competitive field of the destruction of economic value for the sake of another type of value.” This other type is ‘sumptuary’ value, equivalent to Thorstein Veblen’s notion of conspicuous consumption (Baudrillard 1981, p. 113, 115).
[8] Stephen C. Gara, Stephen and Craig J. Langstraat, ‘Property Valuation For Transfer Taxes: Art, Science, Or Arbitrary Decision?’, *Akron Tax Journal*, 12 (125), 1996.

confidence only when auction prices recovered. In short, to buyers, who "drift around [private] dealer rooms – totally in the dark", auction prices "give confidence" and function as "trustworthy benchmarks."[9]

This benchmark character of auction prices was also confirmed by the dealers I interviewed. The owner of an old, established Dutch gallery explained: "I know that the actual price is the price at auction, because only at auction do supply and demand meet. There prices are established after two or sixty seconds of bidding, just like the way people used to negotiate about the price of cows or horses at the traditional market [the gallery director claps his hands]" ($_{NL}$7). An American dealer said likewise that "[t]he auction is of course for all of us the indicator as far as prices are concerned. Everybody has got access to those prices, even the customer, if he wants via the internet. Even the most shrewd dealer will therefore be careful when deciding how much he is going to offer a work for. As a result prices have become much more predictable" ($_{US}$12).

Also, they contrasted the reliability of auction prices with gallery prices which would be "based on air", "speculative" and "one sided": the art dealer and the artist may have agreed upon the price, but the collector does not have a say - at auction he is able to express his willingness to pay far more directly. One dealer emphasized that a gallery price list may say $300,000 for a painting by an art star, but, since "you can write anything in the price list", that price says nothing about the actual selling price. Says an Amsterdam dealer: "A price determination of an artwork is purely an assertion. It has nothing to do with whatever, not with raw materials or production costs. You just say: this is worth that much. Then you have to make sure of course, that you can get away with it" ($_{NL}$11).[10]

One of the few comments Alfred Marshall made about the art world in *Principles of Economics* was that, especially without the moderating influence of professional dealers in art,

[9] Because the acceptance and recognition of young British artists in the late 1990s was widely attributed to the activities of only one collector, Saatchi, the first time the work of these artists appeared at auction was deemed crucial for the determination of their real value. See Hans Hartog den Jager, 'De grillen van een man die alles heeft', *NRC Handelsblad* 12.5.1998. Journalist Peter Watson recounts the story of a New York art dealer who offers paintings of the seventeenth century Neapolitan painter Bernardo Cavallino for $600-700,000. One collector is seriously considering to acquire them for the price. At the very last moment, however, the collector backs out, and the dealer decides to sell the works at auction. To his surprise, the same collector bids at the works, and ends up buying them at a price of 1,700,000 dollar; whereas the collectors was lacking the self-confidence to buy the work privately, the experience that other buyers were willing to bid nearly as high reassured him of the rightness of the price. See Peter Watson, 'Investing in ignorance', *The Spectator* 3.18.1989, p. 35-36; see also Grace Glueck, 'Fresh Talent And New Buyers Brighten The Art World', *The New York Times*, 10.18.1981. Carol Vogel, 'The Art Market; A Crucial Auction Test: Will Prices Keep Falling?', *The New York Times*, 11.1.1991.

[10] In order to make gallery prices more reliable, art dealers in Japan conventionally guarantee the original selling price of an artwork to a collectors who wants to return a painting he bought in the past (Havens 1982, p. 122). One former Dutch art dealer I interviewed proposed a similar system. Dealers would commit themselves to buying back artworks which collectors originally bought at their gallery: "The system is all about giving a signal to people that you back the work up, and thus definitively answer that question if the work maintains its value… it is meant to bestow trust on the buyer with respect to the

"the price at which each is sold, will depend much on whether any rich persons with a fancy for it happen to be present at its sale"; as a result fluctuations in prices at auction are extremely high, Marshall explained (Marshall 1890 [1982], p. 276-277). Echoing Marshall, contemporary art dealers argue that the value of works determined at auction is contingent because it does not depend on repeated sales but instead on the 'excitement' of a single night. Paradoxically, the fact that auctions reflect supply and demand so directly confers an elusive quality on them. One New York dealer, who represents a number of artists with an active secondary market, called auction prices 'chancy', while other dealers used terms like 'bizarre', 'very hard to pin down', 'not real', 'inflated' or 'unpredictable', and emphasized that establishing a high auction price 'only takes two people in the whole world' ($_{US}$15). Another American dealer worded the contingency of auctions as follows: "The auction market is based on the time of the year, if it is raining outside, the mood of the audience, who attended that night, what's in the auction itself, and how much excitement it generated" ($_{US}$14).[11] A stubborn Dutch dealer, operating in the commercial segment of the market, expressed his annoyance with the fact that people are so easily impressed with auction prices ($_{NL}$15).

Apart from their contingent character, art dealers complain about the transparency of the bidding process at auction. This transparency is reduced by a number of institutional features of auction houses and by the strategic behavior of buyers and sellers. For instance, reserve prices can be set so as to insure a minimum selling price (cf. Ashenfelter 1989); when the price is not met, the auction house may contact dealers in the days following the auction to sell the work privately. Although prohibited in the United States under the Sherman Antitrust Act, dealers can 'pool' or 'ring' bids by refraining from bidding against one another, and allocating the good after the auction according to an agreed-upon principle. Thus, a price may fail to reach 'fair market value' (Smith 1989).[12] Furthermore, auctioneers are accused of inventing bids of a telephone bidder in order to increase the price. Allegedly some transactions do not involve genuine acquisitions, but are merely used to increase the value of works by the same artist

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value of the work" ($_{NL}$5). Practically, all galleries would have to deposit a monthly fee in a fund; out of this fund, collectors would get paid the original purchasing price in case they want to sell the work.

[11] As an art adviser noted after the 39,9 million dollar sale of Van Gogh's sunflowers at Christie's, New York: the price "is going to be disruptive" and "will add confusion to this already frantic, hectic situation. It is certainly not a victory." Banker and collector Robert S. Dirie noted that the dynamics of the market changes dramatically if one buyer drops out above the $ 2 million level. Therefore, he called the auction market "dangerous." Bradley Hitchings and Lynne Curry, 'At what price art? The answer is: high, very high', *Business Week,* 12.29.86. Amy Page, editor of the magazine *Art & Auction*, questioned auction prices because they were increasingly based on loans provided by the auction house itself. In the case of the record price paid by Vincent Van Gogh's *Irises*, for instance, the Australian collector Bond who bought the work for nearly $54 million in the fall of 1987, could not repay his loan Sotheby's had provided him. Page remarked that "the public learned that the price of Irises was not real, and Sotheby's was accused of inflating the market." See Pamela Young, 'Masterpieces and Millions', *Maclean's*, 4.16.1990; Richard W. Walker, 'Flower power', ARTNews may 1987, p. 31, volume 86.

[12] Carol Vogel, 'Under a Harsh Spotlight, the Art Market Is Sweating; Dealers and Auction Houses Are Terrified as Federal Investigators Ask About Their Private Realm', *The New York Times* 5.7.1993.

acquired before, whether at auction or in a gallery (cf. Smith 1989, p. 38). For instance, the well known New York collector S.I. Newhouse was suspected in 1989 of buying *False Start*, a work by Pop Art painter Jasper Johns for a record price of $17.7 million dollar with the purpose of increasing the market value of the other paintings by Johns he already owned.[13] Likewise, occasionally some dealers are accused of putting works at auction by an artist the dealer represents, and anonymously bidding on the work in order to create a new, illusory high price level for that artist (Marquis 1991, p. 255; Gee 1981, p. 32). These are reasons for dealers to doubt the prices that are established at auction, leading one of my informants to conclude that "[e]very big collector who buys or sells at auction must just be insane" ($_{US}$12).

In the eyes of dealers, the third harmful aspect of auction prices, apart from their contingency and lack of transparency, is their volatility (cf. Candela and Scorcu 2001). Auction house Christie's was blamed by one dealer for "not only inflating the prices of these works beyond their gallery prices but also prematurely testing the market for some younger artists."[14]; once a high price is set, they aggressively approach collectors in the eyes of dealers and advise them to sell, because "tomorrow will be doom day. The market will collapse, so this is the time to sell" ($_{US}$18). Since too many works appear on the market, the initial high auction price may not be reached again. Thus auction houses actively destabilize the art market. A dealer concludes: "It is a very unfair test for the artist." ($_{US}$18).

The crucial issue here is, to repeat, that an auction house does not have a long term relationship with artists; its single interest, according to dealers, is short term price and profit maximization. By contrast, dealers present their own prices as more stable and more honest since they do rely on repeated sales. Art dealer Paula Cooper, for instance, argued that "the best prices for a living artist are always at the artist's home base – the gallery." Her colleague of the Pace Gallery, Arnold Glimcher, did not believe auction prices in the 1980s, and therefore deliberately kept gallery prices of some of his artists lower. "Everything doesn't hinge on one night like it does in the auction business, and we can protect the works over time, since nothing is publicly burned if it doesn't sell", as Glimcher explained.[15] In short, gallery prices, the prices of the promoters, are set with a long-term orientation in mind, focusing on stability, trustworthiness and care for the artist; auction prices, by contrast, the prices of the parasites, are

[13] Originally, the work had sold for $3,150 in 1960. See 'There's one born every minute', *The Economist*, 27.5.1989; Michael Kinsley, 'The Manet Illusion', *The New Republic*, 1.22.90, p. 4, 42. On the limited transparency of auctions, see Souren Melikian, 'A Transparency Problem. Would you spend millions of dollars in the dark?', *Art and Auction*, March 1990.
[14] Carol Vogel, 'Stars of the Last 30 Years Shock and Sell at Christie's Contemporary Sale, *The New York Times* 11.17.2000.
[15] Donald Judd reprimanded his dealer Paula Cooper because the prices speculative collectors received at auction were sometimes more than twice as high as the gallery prices he received himself ($_{US}$15). Carter Ratcliff, 'Dealers Talk,' Art in America, July 1988, p. 79; Lisa Gubernick , 'Art tutor to the stars', *Forbes*, 12.9.1991; Carol Vogel, 'Inside Art', *The New York Times*, 9.15.1995

perceived as short-term prices, directed at maximizing profits. In this respect, the moral indignation is reflected in dealers' interpretation of auction prices.

Table 1

	Auction price	*Gallery price*
Pricing principle	Supply and demand	Assertion
Character	Public, exposure	Private, protection
Profit orientation	Short term	Long term
Reliability	Single sale, chancy	Repeated sales, stable
Volatility	High	Low
Rationing	Economic	Social

5. Waiting for a work

The previous section suggests that prices established at auction and in galleries not only differ in quantitative, but also in qualitative respects (for an ideal typical classification, see table 1). Dealers seek to 'protect' their prices against the contingency, the lack of transparency, and the volatility of auction prices. They do so by resisting the direct impact of market forces when setting prices; instead, they apply scripts to set prices, which entail setting prices low at the beginning of an artist's career, and increasing these prices only slowly when demand for her work is strong, or when the reputation of the artist amasses. Price setting in contemporary art galleries is in other words a path dependent process, which safeguard a stable market for the artist's work.

Keeping forces of supply and demand at bay, the question is how gallery prices equilibrate the market. I found that whereas artworks are rationed via the price mechanism at auction, in galleries this function of the price mechanism is deliberately restricted. My findings lend further support to an experimental study by economic psychologists Daniel Kahneman, Jack Knetsch and Richard Thaler, who found that respondents deemed the auction mechanism inappropriate as a means of selling goods in case of excess demand (Kahneman, Knetsch et al. 1986). Bruno Frey found likewise that apart from economists, most people favor allocation mechanisms other than the price mechanism (Frey 1986).

In order to allocate the work in case of excess demand for an artist's work, two alternatives exist for the price mechanism. In each case, dealers choose to set prices lower than demand

allows for; in other words, they do not let prices clear the market by selling works to the highest bidder. First, some dealers argue that "[t]he only fair way to do it is on a first come first serve basis" ($_{US}$19). The established New York dealer Ivan Karp maintained likewise that somebody who is willing to pay the price "has the right to acquire the work (….). That is an ethical point that must be respected."[16]

The second alternative to rationing via the price mechanism in case of excess demand is to develop a waiting list for the artist's work and subsequently sell work to favored collectors. [17] In this case artworks are not sold on a 'first come, first serve' basis, but rather on the basis of pre-existing social ties and trust relationships. Such relationships are commonly characterized by frequent purchases by collectors, and dense reciprocal exchanges of gifts and favors. It goes to show that unlike the implicit liberal ideology of economic theory assumes, the market is not necessarily a democratic institution (cf. Friedman 1962 [1982]): on the primary art market, rationing of excess demand is based on social rather than just economic principles.

An American dealer characterized this non-economic mode of rationing as a "chess game" which invariably makes some people happy and insults others ($_{US}$16). Museums, which are of strategic importance, are privileged in this process. In order to control the future biography of artworks, dealers furthermore make a sharp distinction between collectors who are buying for the right, and those who are buying for the wrong reason. 'True' collectors are supposedly motivated by a love for art, and buy for aesthetic reasons only. These collectors think about art as an "intellectual pursuit"; they have "dialogues" with the work, the artist, and the gallery; they "travel to an opening, the artist knows them, they become friends, they follow their career", as a New York art dealer characterizes them ($_{US}$16). Also, true collectors are willing to buy work that is difficult to commodify such as installations. In the United States, they may donate their work eventually to museums, or, in a rare case, fund their own museum. Such donations or sales to museums are not just attractive because of the legitimacy they lend to an artist's oeuvre, but also because the future biography is safeguarded in museums since the work will not appear on the market again.[18]

By contrast, people who buy for the wrong reason are interested in art as a status symbol or as an investment object. Dealers say they prefer people who buy art for decorative reasons to

[16] Carter Ratcliff, 'Dealers Talk', *Art in America*, July 1988.
[17] Cf. *The Nation*, 4.30.1988.
[18] Works of art acquired by museum are, to put it in Kopytoff's terms, terminal commodities; they will not enter a commodity phase again (Kopytoff 1986, p. 75; Thompson 1979). Also, museums avoid measuring the value of the work in monetary terms: the economic value of artworks is considered beyond measurement since they are not commonly put on the balance sheet. Economists oppose these practices fiercely (see e.g. Grampp 1989; Montias 1995). Gagosian, known for his aggressive secondary market sales, remarked about the terminal status of artworks in museums: "I don't like to sell paintings to museums (…) because then I can't get them back"; Grace Glueck, 'One Art Dealer Who's Still a High Roller', *The New York Times*, 6.24.1991.

such speculators or status seekers, but it is also considered inappropriate if a customer enters the gallery and asks for a new artwork that fits above the couch. If neoclassical economists like William Grampp maintain that economists are indifferent to the motives of collectors to buy works, for dealers these motives make a crucial difference (Grampp 1989).

Speculators are avoided in particular, the reason being that speculators violate the moral code of the circuit that art may only temporarily be commodified. Likewise, the objection against collectors who buy art as status symbols is that they see the price as something admirable, and are likely to invoke these prices at 'society' parties (cf. Moulin 1967 [1987], p. 141). Thus, in the hands of both investors and status seekers the artwork does not lose its commodity character. This is deplored by dealers, since they "want the work to function properly, to provide a good context to it, and to prevent it from becoming an object for financial speculation (…), from getting in touch with money again", as a Dutch dealer phrased it ($_{NL}$11).[19] Says another dealer: "You can tell a speculator very quickly.(…) Just the kind of questions they ask, and what they ask for. It is almost like they are wearing a sign on. A speculator would come, and look at your gallery program, and ask for the two things that are most sure to increase in value. (…) When we see each other, they know exactly what I think of them, and they know they cannot buy here, no matter what they want to buy" ($_{US}$16). This, as well as the other elements of the marketing repertoire, suggests that dealers need tacit knowledge to conduct business.

Collectors who are not part of the gallery's circle of key collectors, and who are considered to buy for the 'wrong' motives, have no other option than buying work of popular artists at auction, where they have to pay a higher price and have no extensive body of work to choose from. A premium is in other words paid if no loyalty exists between a collector interested in an artist's work and a dealer that represents her. As a journalist of the British *Art Newspaper* noticed: "[B]ehind those headline figures [at auction] is the stark realisation that the currently popular artists and their galleries simply cannot meet the demands of a swollen contemporary art market. Auction stands to be the continuing beneficiary of disappointed collectors who have lost patience by waiting in line."[20] Apart from the fact that dealers want to have control over the

[19] Renee Steenbergen has shown that some collectors categorically refuse to count the economic value of their collection. Like dealers, they make a distinction between buying for the right and buying for the wrong reasons; buying art for profit is explicitly condemned among collectors. One of Steenbergen's respondents compared a collector who sells an artwork, to a husband who ditches his wife. The only legitimate reason to sell is to 'upgrade' the collection or to generate resources that can subsequently be used to buy new work of young artists (Steenbergen 2002).

[20] Roger Bevan, 'No ifs, some butts in New York sales Gary Hume, Sam Taylor-Wood and Cecily Brown prove that it's never too soon to be an auction star', *The Art Newspaper,* 11.17.2000. Dealer Irving Blum remarked likewise that "[t]here are 50 people waiting for an extraordinary Stella or Lichtenstein or Johns. The problem is getting the material. Because it's so tight, the interest is there. They'll pay the earth to get the stuff." See Grace Glueck, 'Fresh talent and new buyers brighten the art world', *The New York Times*, 10.18.1981. See also Riki Simons, 'Verre van abstract', *Money*, November 1999:70-75.

market and guarantee the long run stability of the artist's price level, they invoke a moral argument for restricting future resale of the artwork: "I don't think other dealers should profit of me and the artist doing a good job. Why should a third party profit? We took risks, so (…) they should get back to us [with the work]", as one dealer argued ($_{US}$17).

6. Erecting boundaries

As a result of the reasoned refusal of dealers to adjust their prices to the auction level, they unwillingly and unintentionally create a wedge between prices on the primary and the secondary market. Indeed, the work of a small number of successful contemporary artists is persistently selling at auction for prices that may be four times as high as the prices set in the galleries. At the same time, the majority of contemporary artists face the opposite situation. Either their work does not have a secondary, resale market at all, or the gallery prices on the primary market are higher than the resale prices for their work.[21] Systematic quantitative data on both types of price dispersion is hard to collect, but available evidence suggests that price differences are structural rather than incidental on the art market. Cultural economists Candela and Scorcu found for the market for prints that price volatility is higher at auction than in galleries, while a long run relationship between prices established at auction and in galleries for similar prints is lacking (Candela and Scorcu 2001, p. 224-227). Pesando found in another quantitative study that prices for identical prints are systematically higher at certain auction houses rather than others, and in certain countries rather than others; the author acknowledges that no satisfactory economic explanation exists for this anomaly (Pesando 1993, p. 1086-1088; see also Pesando and Shum 1996; Anderson 1974; Frey 1997, p. 172). In her study of the French art market Moulin argued that "[p]rices paid for works sold privately are difficult to pin down and vary widely. At any given time a given work may be up for sale at several prices" (Moulin 1967 [1987], p. 137). In short, the market for contemporary art is characterized by 'price dispersion equilibria' (Phlips 1988, p. 14).

The most obvious economic explanation for persistent price differences on the art market is that artworks are unique goods, whereas the theorem that all price differences will be leveled out holds for a perfectly competitive market in standardized, homogeneous goods; price differences between works that look a like and match each other in characteristics such as size, subject matter and style, can thus be attributed to less conspicuous differences in quality. A particular artwork may have originated in a crucial phase of the artist's career, or it may have scarcity value because it was made in a less prolific phase. From an economic point of view

[21] Also in the nineteenth century, the major part of contemporary art that appeared again at auction did not manage to maintain its value (see Hoogenboom 1993, p. 154).

there is no reason to believe that these price differences will be leveled out, because they simply reflect differences in the consumer's willingness to pay for goods whose desirability varies. In the absence of quality differences, neoclassical economists have come up with alternative, more fine-grained explanations for an empirical reality which does not conform to their crude theories. Chicago economist Georg Stigler argued in an early and influential article on *The Economics of Information* that the existence of price differences is a manifestation or measure of the level of ignorance on the market; such price differences can persist because consumers are not aware of them, and mistake the price they are offered for the single market price. Especially markets with a constant influx of new, relatively uninformed consumers will therefore be characterized by price dispersion (Stigler 1961 [1971], p. 70).[22]

In the absence of such consumer ignorance, price differences can arise due to differences in search costs: economists have argued that even when consumers know that price differences exist for a good they want to buy, it takes time to locate the store that sells it for the lowest price. Search costs reflect the value of the time that is spent finding the same good for a lower price. Given the high average income of art collectors, the opportunity costs of this time are high. A utility maximizing collector will therefore proceed to buy a good before the lowest price is found because the expected price difference does not outweigh the additional costs of extra search efforts. Conversely some sellers will abstain from lowering their prices even if they know they are being underpriced by competitors; since their profit margin per unit sold will be higher than their competitors, these shops will not be driven out of business. Thus a market equilibrium comes into being which allows for price dispersion (Okun 1981; Phlips 1988).[23]

My claim is that these economic explanations only partially account for the differences in contemporary art prices established at auction and in the gallery. To repeat, I interpret them as a manifestation of the unwillingness of dealers to adjust their prices to the price level established by supply and demand at auction. The question is, however, how dealers themselves deal with the differences that they allow to exist. In the case of auction prices that are higher than gallery prices, they create opportunities for arbitrage on the side of collectors.[24] In order to undo these

[22] This is typical for bazaar economies, where knowledge of both the quality and the overall price level of products is difficult to obtain. Sellers judge the prior knowledge of customers and adjust their initial offer significantly. Especially if the buyer is a stranger to the bazaar economy, or if his clothing suggests unfamiliarity with market practices, the seller's offer will be considerably increased (Alexander and Alexander 1987, p. 57).

[23] Search costs have been significantly reduced since the 1980s due to the emergence of specialized firms which provide information on prices and availability of artworks by means of newsletters, websites, annual sales catalogues and guidebooks (cf. Stigler 1961 [1971], p. 73); as Louargand argues, the efficiency of the art market has been increased as a result (Louargand and McDaniel 1991).

[24] This strategy of 'underpricing' has been discussed frequently in economic literature, in particular with respect to the pricing of equity at an Initial Public Offering (IPO). Because of a company's underpricing strategy, investors can make an excess return by buying the IPO and selling it as soon as the equity appears on the open market. One explanation for this excess return is that buyers need to be enticed with a

opportunities and prevent such arbitrage from taking place, I found that it is customary to oblige collectors, either on the basis of a gentleman's agreement or by putting it as a clause in the invoice of a sale, to give the gallery first right of refusal in case the collector wants to resell the work. For instance, one art dealer remarked with an understatement that a New York art dealer, whose artists almost invariable have a waiting list for their work, is "probably very concerned that they do not sell the works to people who are kind of known as speculators. They made have even made stipulations on the invoice that they could not sell it right away, or if you sell you have to offer it to them first. (…) I am sure they took great efforts to make sure the work went to museums or collections where the collectors or not known for doing that kind of thing. They don't want the work on the market" ($_{US}$15). Another dealer explained: "If there is a Luc Tuymans on the secondary market, that is here, not at the auction houses. Because the collector does the right thing, he gives it to us, so that we feel good about him buying other works, even by this artist. If he would put it at auction, we would never sell to him again, we punish him" ($_{US}$16).

Also I was told that black lists circulate of collectors who have a reputation of frequently reselling work, and mainly buying contemporary art for speculative reasons. In order to 'protect' their own prices and safeguard a stable market for the artist's work, such collectors are avoided by dealers. Almost invariably, Charles Saatchi, an English collector who has a reputation for buying work of emerging artists in quantity and selling them at auction, was as a quintessential speculator. One dealer argued that selling to him amounts to selling to another dealer. Artists such as Sandro Chia, Robert Ryman, Sean Scully and Robert Mangold, who fell victim to his speculative activities, characterized Saatchi's sales as "sad", "horrible" and described him as somebody who is unable to discriminate between individual paintings, but instead treats all of them like commodities (Watson 1992, p. 434).[25]

In the opposite case of lower auction prices, which manifests itself more frequently, dealers sometimes become market makers: they take position by buying work of the artists they represent. Contrary to market making on financial markets, the goal of this action is to support prices, rather than to enhance the liquidity of the market. Also, dealers refrain from decreasing gallery prices. Indeed, a strong taboo on price decreases, which are necessary to move the market back into equilibrium, has been widely recognized in academic literature on the art market (Moulin 1967 [1987], Plattner 1996, Klein 1994), it appears in artist's guides to the

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lower price to buy the stock since they are uncertain about its value (see e.g. Levis 1990, p. 87); another explanation is that companies are risk averse, and therefore set the price low enough for investors to get interested. Neither explanation for underpricing is related to a taboo on price decreases.

[25] On Saatchi, see Grace Glueck, 'A Leading Art Collector Is Selling, And the Market Wonders Why', *The New York Times* 11.23.1989; Hans Haacke, 'Text and Images. The Saatchi Collection', *Art Journal* 2 (48), Summer 1989, p. 186-189; Tony Godfrey, 'Decline and Fall', *Art in America*, 63-65.

market (e.g. Chamberlain 1983, p. 81; Katchen 1978, p. 80) and it is universally acknowledged by the dealers I interviewed. When I asked if price decreases are appropriate, dealers gave answers such as: "there is an absolute taboo on the decrease of prices" ($_{NL}$7), "the problem is that if your prices are very high, you cannot go back anymore" ($_{NL}$16), "I have a moral responsibility to maintain the price, a responsibility towards the community I am involved in" ($_{US}$11), or "a work of art is never decreased in price, never" ($_{US}$14).

The reasons for refraining from decreasing prices must be strong, since it results in exhibitions where works remain unsold; also, by refusing to lower gallery prices, dealers run the risk that collectors start buying works at auction rather than in the gallery. Dealers explained, however, that these dangers do not outweigh the negative signal which price decreases send out: price decreases not only demoralize artists and offend collectors who have bought work by the artist concerned in the past, they also harm the reliability and trustworthiness of gallery prices (see Velthuis 2003). Again, volatility of the auction market is resisted in galleries in an attempt to stabilize the market in the long run. Thus price differences are persistent on the art market.

7. Conclusion

This paper has examined structural differences between the primary and the secondary segment of the art market. From the perspective of dealers, auction houses are the parasites of the art market, eager to make a quick profit, galleries intend to take care of the long term promotion of contemporary artists and establish a firm market for their work. Within this perspective, art dealers not only distinguish prices along qualitative, but also along quantitative lines; they categorically separate their own gallery prices from prices established at auction. Both types of prices are not only determined and adjusted differently, also the type of rationing in case of excess demand differs crucially for both segments. Moreover, the moral connotations of prices established at auction differs significantly from those of gallery prices: gallery prices are prices of the artist's promoters, whereas auction prices are considered 'parasitic.' In other words, the values underlying gallery and auction prices differ radically. These different moral connotations have real consequences: contemporary art dealers construct moral and even legal boundaries to prevent arbitrage from taking place. Thus they protect gallery prices against 'unreal' auction prices, restrict the liquidity of the market, and sabotage the acquisition of art as an investment good.

Galleries do not use the price mechanism to ration work by artists in case of excess demand, but rely on waiting lists instead. These waiting lists enable the dealer to decide who gets the works, and puts him in charge of the long term price development of an artist's oeuvre. Conversely, if gallery prices are higher rather than lower than auction prices, the gap fails to

close due to a strong taboo on price decreases: since a price decrease conveys negative meanings to collectors with respect to the economic value and artistic quality of the artwork, they are avoided.

My findings cast doubt on the economic perspective on the price mechanism as a neutral, anonymous, and meaningless allocation mechanism. By restricting the 'fungibility' of auction and gallery prices, they prevent a single price equilibrium from coming into being. This behavior may be irrational from a narrow economic point of view, it makes sense from the perspective of an art dealer who wants to promote an artist, and safeguard the long run stability of prices. There is in other words a rationale to maintaining price differences, albeit not a strictly economic rationale.

An economist's response may be that following this argument, the product you buy simply differs: an acquisition of a work at auction is different from buying a similar work in a gallery, if only because of the public character of the first setting, and the privacy of the second; such immaterial differences might justify differences in price. The question is, however, if such an encompassing argument illuminates the social and cultural intricacies that pricing art entails. The implicit argument of this chapter is that prices are used as a tool to make sense of the economic world art dealers inhabit and to express the values that constitute their identity as dealers. Pricing, in other words, is not just an economic, but also a signifying act.

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