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**Harmonising the Droit de Suite: An  
Economic Analysis of the EC Directive**

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## **Authorship Declaration**

*I hereby declare and confirm that this thesis is entirely the result of my own work except where otherwise indicated. I acknowledge the supervision and guidance I have received from Prof. Dr. Hans-Bernd Schäfer.*

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## **1. Introduction**

“the right for the author, or after his death for his heirs or other beneficiaries, to receive a percentage of the price of a work - being usually a work in the field of the graphic and plastic arts - when it is resold by public auction or through an agent”<sup>i</sup>

The consideration of resale rights for visual artists is of only minor importance to the global economy as the sums of capital involved are small and a very limited class of individuals will ever be affected by *droit de suite* legislation. Despite this the area has been the subject of a disproportionately large volume of academic literature as an increasing number of serious and respected economists have used the field to put law and economics analysis into practice.

As there have been numerous introductory articles on the legitimacy of *droit de suite* legislation, including a master thesis on his programme, I will attempt to focus on some of the more interesting theoretical questions raised by this issue such as the role of inalienable rights and their impact on the market. Although this paper will not be an overview, certain areas of common ground will have to be covered first before considering the distinguishing features of the new EC legislation. The analysis of *droit de suite* legislation here has to be primarily theoretical in nature as the field lacks extensive empirical research and the complexity of the art market makes quantitative statements difficult.

The notion of a *droit de suite*<sup>ii</sup> has existed since the 1920's when it was introduced by the French Government as extension of French copyright law<sup>iii</sup>. The form of legislation differs between states and is enforced with varying degrees of enthusiasm but the essential element is that once an individual or corporation has purchased a work of art, to which the legislation applies, then subsequent sales of the work require a certain percentage of the fee to be reimbursed to the artist.

At present statutory provisions for an artist resale right exists in 29 jurisdictions across the globe including Italy, Germany and the state of California. Notable absentees from this list, where there are no such provisions, include the United States of America (at the federal level), the United Kingdom and Switzerland. Due to problems of enforcement and high costs it has been reported that only five countries apply *droit de suite* legislation in practice<sup>iv</sup>.

Most advanced economies are signatories of the Berne Convention for the Protection of Literary and Artistic Works that includes in Article 14 the recognition of *droit de suite* as an author's right. The provision is not mandatory however and operates under the principle of substantive reciprocity. An author can claim a resale royalty, as provided in convention, when in a foreign country to the same extent as home nationals but only if the author's home state also recognises the *droit de suite*.<sup>v</sup>

The principle of reciprocity came under threat after the *Phil Collins* case,<sup>vi</sup> even though the actual claim did not relate to resale royalties but concerned disputed rights in performances in Rome Convention countries. However the European Court of Justice judgement had wide reaching repercussions as copyright and all related rights now had to be evaluated with reference to the principle of non-discrimination on the grounds of nationality. The present situation for EC Member states is that if they provided a resale right to domestic artists then they also have to provide the same level of protection to artists from all other Member states, irrespective of whether the country of the artist in question actually applied such a right. The next major development will be the creation of a harmonised resale royalty system across the European Union with the introduction of Directive 2001/84/EC.

I will begin the body of my thesis with background information relating to the decision by the French Government to develop this novel legislation. The motives have never been explicitly stated, although the circumstances of the day clearly had an influence, and it is important here to briefly review the historical context. I follow this with an explanation of the legitimacy of the directive and European Commission's justifications for the need for EC legislation in this area. I shall provide an overview of the principal features of the legislation that they enacted paying particular attention to aspects that are more controversial and have caused disagreements in the academic press. The second chapter concludes with a consideration of the rights conferred on the artist and how the practical measures within the Directive limit its applicability.

The third chapter delves deeper into the issues raised by the *droit de suite* beginning with analysis of the incentives that a royalty right creates for the affected parties and whether they facilitate efficiency and minimise transaction costs. I shall consider the significance of the declaration that the right shall be inalienable and how this compares to the traditional rules of

transferable property rights. I will provide an overview of the leading economic literature in this field and the applicability of law and economic theory to this aspect of the *droit de suite*.

A principal argument in favour of resale royalty legislation is that visual artists are under protected in comparison to other copyright holders. Therefore I survey the rights of authors and composers highlight the reasons that evolution of copyright has not created a 'level playing field' for all creators of literary and artistic works. I conclude the chapter with a consideration of a contractual approach to the problem rather than state enforced regulation and assess the relative benefits and drawbacks.

The fourth chapter considers the predicted effect of the Directive on the market. I will begin by demonstrating that the European Community was faced with a problem of Public Choice and how this resulted in a compromise between the wishes of the various EU member states. I will consider how the European Commission sought to appease concerns of a migration of art sales to third countries but has resulted in a less effective instrument for the protection of the visual artist. I will provide an overview of royalty arrangements in the primary market and show what lessons can be learned for legislation of the secondary market. I will conclude by demonstrating that the *droit de suite* is one of numerous factors that effect art sales and how the wider picture must be taken into account.

## **2 The Emergence of the *Droit de suite* and enactment of Directive 2001/84/EC**

### **2.1.1 Historical Origins**

The artistic profession has traditionally been a relatively wealthy and skilled craft based on personal service contracts between artists and buyers to create murals and sculptures that could only be resold as part of the domicile.<sup>vii</sup> The artist was secure in the knowledge that there was a certainty of sale as a fee would be collected on completion of the commission. Once painting on canvas became more widespread and artistic works became transportable the structure of the market altered beyond recognition. Art was soon seen as a tradable asset and works gained prestige value as reputations began to become established. Unfortunately the new market conditions produced a 'double edged sword' effect as it opened up the potential for competition from fellow artists but also from the resale of past masters.

The French Government assisted artists by the formation of the Academy of Fine Arts in 1648 which regulated the Paris Salons, large scale exhibitions where art work that was accepted by a specialist jury would be allowed to be put on view to the general public. Attendance at such events could reach ten thousand a day and any one salon could include five thousand paintings. The fundamental flaw was that the jury considered only traditional forms of artwork and modern and innovative techniques were largely ignored.

The impressionist movement was a victim of this exclusive treatment and between the 1840's and the 1890's a series of artists from Meryon to Van Gogh epitomised the 'starving artist' phenomenon where the lack of official recognition required them to sell their works for a nominal fee to private dealers whilst living in poverty.

### **2.1.2 The 'Starving Artist' Phenomenon**

By 1885, the official Salon system had completely collapsed; as Impressionism had gained in popularity a significant distribution network had emerged outside the official sales channels for works of art had developed to meet the consumers' preferences.<sup>viii</sup> Public perception of aesthetic quality had changed and once the American market began to appreciate the impressionists' works that had been so widely ignored in the past there was a sudden surge in demand to acquire the works whilst the asking prices remained so low. The market for impressionists soon grew and substantial profit margins became possible when selling innovative modern art. Unfortunately the artists and their estates had already surrendered all their rights in such works and while the dealers became wealthy businessmen the artists' children continued to labour in poverty.

### **2.1.3 Movement away from State Regulation**

The introduction of the *droit de suite* legislation was seen as a move away from direct state financial support for the graphic and plastic arts to a system where the art market was self-supporting. The *droit de suite* legislation provided an early example of a legal mechanism designed to function in the free market and exposes the system to the rigours of supply and demand market forces whilst still offering partial protection to artists.<sup>ix</sup>

In recent years art prices for famous works have escalated and reached a peak in 1989 when DeKooning's "Interchange" fetched \$20.7 million at auction and this has again ignited the debate for resale right regulation. A key question is that as the *droit de suite* legislation in France was a legal response to a set of specific conditions that existed at the time do those conditions still exist today and does the *droit de suite* still have contemporary relevance?<sup>x</sup>

## **2.2 Directive 2001/84/EC**

### **2.2.1 Legal Basis - Subsidiarity, Proportionality and Constitutionality**

After several years of negotiation and discussion the European Commission devised a directive proposal which was accepted unanimously by the member states and with its enactment in September 2001 has brought provisions for an artists' resale right onto the EU law statute book.<sup>xi</sup> The directive has to be implemented by 1/1/2006 in member states already governed by such legislation but member states that will be introducing such laws for the first time have a deadline of 2010 with the possibility of an extension until 2012.

The European Commission stated that they had the appropriate legal basis under Article 95 of the EC treaty to enact procedures in order to assist the functioning of the internal market as stated in Article 14<sup>xii</sup>. When assessing the need for the implementation of EC Law in this area the Commission has to be watchful to respect the principle of subsidiarity as stated in Article 3b of the EC Treaty.<sup>xiii</sup> The assessment essentially takes the form of a "comparative efficiency test" and it needs to be shown that alterations at the European level will result in greater efficiency gains than action that can be taken by the member states at the national level. The principle of proportionality must also be respected to ensure that the measures taken do not exceed what is necessary for the intended goal.<sup>xiv</sup>

The risk of exceeding their jurisdiction is that the constitutionality of the legislation is challenged as happened in California with the implementation on the State level in 1977. The Commission has to be confident that none of the basic rights provided for in the new European Constitution are infringed.

### 2.2.2 Rationale

The protection of literary and artistic property is subject to national law and unless there are express provisions within the EC legislation then disparities are allowed to exist. The ECJ however has expressed the concern by their very nature industrial and commercial property rights can affect intrastate trade in goods and services and in doing so influence the competitive relationships between Member States.<sup>xv</sup> The market was perceived as functioning inefficiently and state intervention was necessary to prevent the ‘race to the bottom’ that was resulting from competition between the states as it was seen as causing harm to the artistic community.<sup>xvi</sup>

The European Community identified the *droit de suite* as a potential barrier to the movement of goods and a hindrance of the progress towards a single market as it distorts competition. The initial recommendation was for member states to remove national resale right laws through the domestic legislature. The response from the Member states was muted.<sup>xvii</sup> After a hearing on 24 February 1995 “a majority of Member States were far from ready to contemplate this, being of the opinion that a generalised application of the artist’s resale right would put an end to the inequality of treatment of contemporary artists in the various Member States while promoting a harmonious development of the art market.”<sup>xviii</sup>

Removal of legislation for such an intellectual property right may require extensive compensation to remedy the harm caused by a redistribution of wealth between the artists and collectors. The European Commission may be reluctant to simply cancel expected royalties as owners of artistic works receive an unexpected profit and the creators lose a stream of expected revenue. The Commission was therefore encouraged to move towards a harmonisation measure at the European level.

The European Commission has drawn on past experience of member states to attempt to achieve a compromise that offers an enforceable regime for extracting royalties that benefits creative artists but in doing so causes minimum impact on the functioning or competitiveness of the European Union Art Market. In addition to the Commission’s concerns for the functioning of the common market, consideration still has to be given to the maintenance of the EC’s competitive position within the global economy and a balance needs to be met.<sup>xix</sup>

Even though resale royalty rights for visual artists continue to be criticised in the economic commentary they remain political popular. As a political entity the European Commission attempting to ‘maximise aggregate political support from all interest groups’ and ‘at the margin’ they will alter a rule if the political gain from one member state outweighs the expected loss in support from the rival member state. The Commission is in familiar situation that it must attempt to satisfy or appease as many states as possible.<sup>xx</sup>

## **2.3 Particulars of the Directive**

### **2.3.1 Rights Conferred by the Legislation**

Before I proceed into the economic analysis of this legislation I consider it useful to highlight the particular distinguishing features that this directive intends to implement. The Directive 2001/84/EC applies to all original works of art<sup>xxi</sup> that are presently afforded copyright protection, (the lifetime of the creator and seventy years after their death.)<sup>xxii</sup> The restriction to require royalties for only relatively modern works of artist means that the highly lucrative estates of artists from the impressionism era are not eligible and so only a small percentage of art sales will actually be effected.

The class is limited to visual art forms expressly referred to in the Directive and does not include literary or musical works. The Commission is seeking to create a level playing field so that all types of artistic work can now be considered as fairly compensated. The commission has stated that this legislation ‘will help to redress the balance between the economic situation of authors of graphic and plastic works of art and that of other creators who benefit from successive exploitation of their works’<sup>xxiii</sup>. A fundamental reason behind this statement was that graphic and plastic works are considered to be primarily exploited through sales of the original piece while profits for other forms of creative art are sought through reproduction which is an area already substantially protected by copyright.

The member states can determine the minimum resale price upon which the legislation can apply but this threshold must not be below 3000 Euros<sup>xxiv</sup>. The resale right will apply to all public sales by auction houses and art professionals as the commission acknowledges that there are practical problems of monitoring costs to include transactions between private individuals.<sup>xxv</sup> An important restraint on applicability is that ‘where the seller has acquired

the work directly from the author less than three years before that resale and where the resale price does not exceed 10,000 Euros' then no royalty will be due.<sup>xxvi</sup> This provision is designed to allow artists and dealers flexibility in their approach to the primary market (discussed later in section 4.3.)

The sum payable will be calculated as a percentage of the sale price net of all applicable taxes. The required percentage will be calculated on a digressive scale as follows;<sup>xxvii</sup>

Price Level	Percentage Applied	Maximum Royalty from this Level
3,000 – 50,000	4%	1880
50,000.01 – 200,000	3%	4450
200,000.01 – 350,000	1%	1450
350,000.01 – 500,000	0.5%	750
500,000 +	0.25%	3970
<b>Total</b>		<b>12500</b>

The maximum royalty that can be payable is 12,500 Euros which means that no percentage of the selling price will need to be reimbursed to the artist for any money earned above 2,088,000 Euros

Following the European Directive Tracy Emin would be eligible for 6430 Euros if one of her photographs fitted the conditions of applicability and was resold at auction within the EU with a net price of two hundred and ten thousand Euros. The break down of the royalty rates that would apply are indicated in the following table:

Price Level	Percentage Applied	Maximum Royalty from this Level
3,000 – 50,000	4%	1880
50,000.01 – 200,000	3%	4450
200,000.01 – 350,000	1%	100
350,000.01 – 500,000	0.5%	0
500,000 +	0.25%	0
<b>Total</b>		<b>6430</b>

In order to make the legislation responsive to market changes if the commission has miscalculated the transaction costs a review is scheduled to take place every four years and upon completion may recommend alterations to the minimum threshold and the applicable royalty rates. The commission may have been better advised to conduct this review through an independent body or a committee because there is a risk that to pass an amendment

through the European Community decision making process may restrict the speed and efficiency of such changes.

The resale royalty is payable by the individual selling the work.<sup>xxviii</sup> ‘The resale right is an unassignable and inalienable right enjoyed by the author’<sup>xxix</sup> and so cannot be waived by any party. Member States will only grant artists from third countries a resale right if there is a principle of reciprocity with EU member states. There is a degree of flexibility as the member states have discretion on how best to collect the royalties as the member states can determine the system that creates the lowest transaction costs.

### **2.3.2 Limited Application**

The limitation to modern works and the threshold requirement means that the application of the legislation is limited to only a small percentage of works sold on the resale market. The Bureau of Labour Statistics has stated that the number of artists, sculptors and artist-print makers was 189,000 in 1989. A recent report from Jeffrey. C.Wu<sup>xxx</sup> based on empirical evidence from the 200 leading US auctions houses stated that works by 357 living artists achieved resale value of greater than \$1000 (considerably lower than the EC threshold.) From the sales above this level 94.7% of the total revenue generated was from works by just 71 artists. While the *Droit de suite* does not apply at the federal level in the United States the data is useful to demonstrate the disproportionate nature of art sales on the resale market.

Benefits are more widespread in the French market where the *droit de suite* is in place but the threshold presently only stands at 15 Euros.<sup>xxxi</sup> The annual collection of resale royalty rights stood at 17 million Francs in 1990 and was distributed between 1700 artists<sup>xxxii</sup>. However the majority still goes to a very select group and in 1996 seventy percent of the *droit de suite* levied went to just seven artists including the estates of Picasso and Matisse.<sup>xxxiii</sup> A criticism of the legislation is that this small class may already be receiving substantial incomes from copyright revenues associated with reproductions. The market for items such as posters and retrospective books would not have been a consideration when the original French legislation was drafted.

The implementation of a minimum threshold value that a sale price must reach before the *droit de suite* legislation applies is an attempt by the Commission to take transaction costs

into consideration. Obviously the commission would prefer a lower threshold to benefit the maximum number of artists but there will be a point where the costs involved may exceed the potential royalty gains and result in inefficiencies if forced upon the seller. The artist may still benefit but the situation is not Kaldor-Hicks efficient as the gains are outweighed by the seller's losses and there is a drop in overall social welfare.

### **Chapter 3 – Further Analysis of Key Issues**

#### **3.1. 'Reputation Effects and Incentive Analysis'**

The droit de suite raises concerns regarding the willingness to pay of potential buyers for original works. The initial purchase price would fall in tandem with the 'present discounted value of the expected future payments that the artist can claim.' The buyer has factored in the cost of the resale right.<sup>xxxiv</sup>

The artist is therefore sacrificing a certain initial return for a risky (or uncertain) later return 'of roughly equal present value.' There are two problems here, firstly the administrative measures will result in greater costs for the same return if a resale right is used and secondly it can be expected that artists will be risk averse and will derive a lower utility value from the riskier payment. An artist is considered a greater risk bearer than a gallery or collector, as they cannot diversify the risk away as easily with alternative investments.

The purchaser of an artistic piece is limited with the price they can achieve through a resale due to the necessary payment to the artist. If the buyer could sell on and receive the full value of the work then there would be greater incentive to part with the item. The promotion of the work may be greater when there is an absence of claim and so the artist receives greater publicity from the resale and more attention often equates to an increase in the value of a work.

The degree of exposure the artist is afforded in society is a substantial factor in achieving success as it increases consumer demand for their works. Where there has been a concern for the prosperity of the artistic community certain commentators have justified *droit de suite* legislation as an instrument by which the artist can insure against the risk of an inability to taste the rewards of their success. As the artist's public profile rises past works become

valuable and they cannot internalise the benefits of their success, as they no longer have any ownership rights.

The ‘pain and suffering’ of living in poverty whilst others live off the fruits of the artist’s labour may be seen as severe enough to make the acceptance of lower initial prices worthwhile. In other words it may be worth the risk ‘premium,’ deducted from initial income, if it avoids seeing paintings becoming very valuable and receiving no financial return.

The perceived effect of resale rights on the reputation of artists has been stated as ‘the most convincing justification for recognising artists’ moral rights.’ The value of any given artistic piece will primarily be dictated by the overall value of the creator’s portfolio. During their career an artist will usually create a substantial body of work. A consistent stream of high calibre work will often bolster an artist’s reputation and as the value of new works continually increase then this creates a positive externality where by earlier works will also increase in value. An important factor is whether new pieces complement the previous portfolio or are substitutes for prior works when artists return to an earlier style when not successful, thus probably rendering those earlier works less valuable. De Chirico is a prime example of the latter where as Picasso is an enlightening example of the former as his works from the Blue Period would have been of little value today if it were not for the public interest in his later more abstract style.

As with any investment an important tool is to be able to predict the future performance of a young artist. In addition to seeking encouragement from the ‘potential’ of early work it is necessary to look at the artists talents, degree of ambition, work level and ability to promote their own reputation. Certainly the artist should have the greatest insight into some of those personal characteristics. In order to achieve success the artist needs the art community to invest in their work. An efficiently working market will provide the methods for potential investor to distinguish between high and low quality artists analogous to the use of warranties and guarantees for other commodities.<sup>xxxv</sup>

A royalty right can, at least in theory, be used in this manner. When an artist is willing to accept a reduction in the initial sale price in return for a future payment as a percentage of any subsequent sales then they are indicating to the market that they have confidence that

their work will appreciate in value. The investor will be encouraged by this as it indicates that they can profit from future sales of the asset but also that the artist will intend to attempt to increase the works value in order to maximise their own royalty revenue. Artists with less confidence in their work will rather accept the certainty of a higher initial price or they will be encouraged to leave the market, leaving only the stronger artists and perhaps a 'richer artistic patrimony'.<sup>xxxvi</sup>

Both of these factors may encourage efficiency gains. The concern is that it becomes so important to 'signal' your confidence in your work that it becomes a necessity and artists have to 'over signal' and take excessive risk and a below optimum initial payment. Purchaser would then also stand to lose out as what they interpreted as a high quality work fails to achieve the returns they expected on the resale as it was merely a low quality work and the incentive system would break down.<sup>xxxvii</sup>

There are personal benefits to the artist to build on their reputation as a more prestigious artist can command higher prices for original works but also there are positive externalities to the benefit of buyers (social benefits), as previous works then become more valuable. If the artist still retains a royalty right in the earlier works then they will have greater incentives to build on their reputation as some of the positive externalities have been internalised.

Where an artist has such an interest in their back catalogue then they still have incentive to maintain their reputation even after they have left the profession. In this regard other moral rights are also supported such as right of integrity so as to provide some encouragement to investors that the value of their purchases will remain intact, maintain marketability and if these moral rights can be wavered then they are still protected by the *droit de suite* legislation. The artist therefore has a 'continuing financial stake in the value of all the work that he has produced' and is provided with incentives to 'serve as a good fiduciary duty for the interest of the current owners of his works' as well as the 'public at large by continuing to police his moral rights'.<sup>xxxviii</sup>

## **3.2 Inalienable Rights**

### **3.2.1 Connection to Moral Rights**

The EC Directive intends to use inalienability as a means of correcting market failure<sup>xxxix</sup>. The commission is obviously not satisfied with the functioning of the market and additional safe guards are necessary for the protection of creative artists. We make a distinction here from the typical use of inalienable rules to exercise *pure paternalism* and prohibiting transactions such as sale of children entirety for the good of society in general with *self-paternalism* where the state does not consider an individual's actions to be in their own best interests.<sup>xi</sup>

Commentators have often included *droit de suite* into a wider sphere of *droit moral* (moral rights,) where states have intervened to protect the artist, as a purely contractarian approach is deemed insufficient. Commentators have perceived that the *droit de suite* has characteristics of a 'personality right' especially as all states that presently have such provisions have granted the right without right of alienation.<sup>xli</sup>

Moral rights legislation often includes a right to integrity and a right of paternity. The former allows the artist to maintain the right to prevent alteration, mutation in inappropriate association of the work by subsequent owners if it prejudices the honour or reputation of the creator. The latter allows the artist associate or disassociate themselves with their creative works. States differ in their treatment of moral rights and certain countries such as Canada provide such protection for artists but allow them to waive their protection. Moral rights can all be considered from an economic viewpoint as they affect the value of an artist's portfolio.

### **3.2.2 Traditional Approach to Limiting Alienation of Property**

As an inalienable economic right the provision of a resale right has certain qualities analogous to a right of distribution as artists have limited control over the subsequent disposal of their works.<sup>xliii</sup> Such limitations on the sellers of artistic works come into direct conflict with the traditional rights of property. The traditional economic standpoint in a fully functioning market any restrictions on the transferability of property rights will lead to efficiency losses as they prevent resources ending up in the hands of those who value them most.<sup>xliii</sup> Bargaining theory provides the foundations for the economic analysis of property law and optimal efficiency can be achieved if all possible Pareto efficient transfers have taken place.

In general property rights must be transferable to facilitate the movement of rights from lower value to higher value uses and so ensure efficiency.<sup>xliv</sup> One condition is that they are willing bargains struck between parties at mutually acceptable prices and provide no externalities.

### **3.2.3 Transaction Costs Model**

Guido Calabresi and A. Douglas Melahmed have developed a useful transaction costs model in regards to the regulation of property.<sup>xlv</sup> They subdivide statutory laws into property rules and liability rules. Property rules are a scheme of free transfers between willing buyers and sellers. Liability rules are, by contrast, a scheme of allowable coerced transfers at market prices set by official entities such as the courts. Someone may use or even destroy the initial entitlement provided they are willing to pay an objectively determined price for it. Where the costs of negotiation towards an agreeable price are prohibitively high then a liability rule that reduces these costs may be justified.

Ownership of property is often seen from legal perspective as possession of a bundle of rights. A private dwelling is an example of a property that is dictated by both property and liability rules. Property rules include the right of possession and the allowance to use the land in anyway the owner pleases provided that property rights of others are not infringed. Liability rules include regulation of eminent domain, as the Government reserves the right to possess or destroy a private domicile for public purposes such as the construction of a new railway. In certain circumstances a set level of compensation must be awarded, but in all cases the Government must not exceed its powers granted by statute.

Property rules are generally seen as prima facie efficient and so liability rules are granted only as an exception. Certain areas such as compulsory purchase cannot be governed by property rules because hold up costs and free rider problems tend to exaggerate individuals' claims and create prohibitively high transaction costs.

Certain rights in relation to a domicile are also often inalienable for example the disposal of a property by incompetent persons or minors. Under an inalienability rule the transfer of the particular right is prohibited even though there are willing buyers and sellers. Calabresi and Melahmed consider inalienability in the same light to grant certain rights as inalienable, and

thus non-transferable, maybe useful only in exceptional circumstances. As a general rule transfers of property should only be struck down where the conditions of the transaction are seen to be unconscionable. Where the process was between capable consenting adults without indication that either party is under duress then a transaction should be upheld. A transfer should not be voided when a party to the agreement *ex post* claims the substance of the agreement to be unfair.

The well-known example used to illustrate this is a consideration of pollution. Free rider problems mean that affected public cannot pay off the land owner to prevent him from selling to a polluter even though there are significant social costs inflicted on society which are not internalised by the sale. The large numbers affected means that means that the prices would be so high that no party would be willing to pay them. The only tenable solution is an outright pollution ban. The discussion here need not be focused on moral issues such as health and quality of life but can be framed in market rhetoric as the effect of pollution on the value of the neighbouring land. Both property rules and inalienable rules apply here as most rights in the painting can be transferred with subsequent sales such as the right to put the work on public display but there is no possibility to assign or waive the artists' right to retain their financial interest in the work.

#### **3.2.4 Paternalism, Distributional Justice and Inequality of Bargaining Power**

The only circumstances where restrictions on transferability are justified are when the market fails to function correctly and there is deemed to be market failure. In this scenario restrictions may be implemented as second best responses and can improve efficiency. In respect to *droit de suite* legislation there are concerns that the strong position of the dealers in the market and the inability of artists to co-ordinate a resale royalty mechanism would lead to unfair contractual terms having to be accepted by the artists.

The underlying justification for the European Community's initiative is a paternalistic attitude towards artists as they consider that as owners of a resale royalty they are not capable of utilising it to maximise their own welfare. Inalienability is seen to be dictated by three normative rationales.<sup>xlvi</sup>

In addition to the pursuit of economic efficiency there are also certain specialized distributive goals and there is an incompatibility between unfettered market processes and the responsible functioning of a democratic state. Rules should be left to the market and freedom of contract unless one of these three factors applies.

The use of inalienability to achieve distributional justice can only be justified to 'prevent monopoly gains' and where distributive costs that arise from efficiency based restrictions burden a certain group to the extent that the restrictions are unjustified. The Government needs to be vigilant to ensure that the use of an inalienability rule does not hinder the development of other solutions for lowering the transaction costs associated with a property rule.

Where there are concerns that a transaction has occurred as a result of unequal bargaining power then it may be struck down as unconscionable as one party is in the position to exploit a particular weakness of the other. The area of regulation includes such concerns areas such as undue influence, duress and misrepresentation and in this situation the contract should not be valid as on efficiency grounds it is no longer a mutually beneficial contract.

Supporters of the imposition of a resale right have alleged that artists are victims of monopsony power although it is unclear without empirical evidence to assess whether such a problem is prevalent. A monopsony exists when there is only one potential buyer who has sufficient power to pay only the reservation price for an artist's work. The fee is provided in current capital as the artist has limited potential to borrow against expected future earnings and so initial prices cannot drop any further.

A government has to consider questions of policy as to whether to permit an individual to maintain such a right in their work and if the state wishes to allow such protection whether a *droit de suite* provision will be compulsory for all artists.

### **3.2.5 Contractual Alternatives and Economies of Scale**

A resale right requires an extensive infrastructure if it is intended to operate effectively. The European Commission has stated that the member states are best positioned to organise the collection of the *droit de suite*. The infrastructure already exists in many states for collection of royalties, either specifically for a resale royalty or at least copyright royalties for reproduction of the work.

Requirements include widely available information on transfers of works of art. ‘Purchasers of artworks must be made aware of the existence and nature of the right and a recording system must be established for maintaining records of the ownership and sales of artwork covered by the right.’ Certain costs may be shouldered by the state but a percentage will undoubtedly be met by the industry.

Economies of scale dictate that if resale rights were established by ‘private means’ then only a few would risk retaining the right, as initial fears that duty would not be collected. In the past attempts have been made to create ‘standard form’ contracts so that the artist and collector can come to an agreement with a greater certainty of the conditions that apply. Unfortunately they have not been successful due to the administrative costs involved.<sup>xlvii</sup>

A limited number of participating artists will result in higher transaction cost per work to which it applies and result in a further reduction in those seeking royalty and the system will fall through. The motivation to deviate from the regime will always be higher than the incentives to maintain it.

Collective action is necessary to keep costs to a minimum but even mutual agreement is difficult to enforce and if the *droit de suite* appears to be ‘efficient as a general practice’ then it follows that a government should make an unwaivable right.

To demonstrate that the right is efficient as a general practice takes time and could be possible with the commission’s four-year reviews but it is unclear with efficiency cannot be proved. Existing European regulations do not provide assistance in this regard.

### **3.3 Comparison with Composers and Authors**

A useful comparison to the Directive 2001/84/EC is the royalty payments afforded to authors and composers where a similar cost and benefit trade off exists and a corrective system is already established. A brief analysis of the similarities between these systems is also instructive as to determine whether the EC directive now provides visual artists the same level of protection as their counterparts in other areas of the creative arts. The resale right has been introduced by the Commission in order to become an ‘integral part of copyright’ law and it is claimed to be necessary ‘for providing creators with an adequate and standard level of protection.’ A principal problem with a *droit de suite* in this form is that it is a continuing property right and in most legal jurisdictions such rights are, in practice, almost impossible to create or enforce unless explicitly provided for in statutory law. However many arguments for the *droit de suite* are analogous to those used to justify or discredit the continuing property rights that exist for copyrights and patents which exist in established and successful systems.

Creative individuals other than visual artists are commonly compensated through royalty payments in preference to a lump sum for the sale of the copyright. The same objections are often forwarded for authors as they are for artists. Royalties shift authors’ incomes from early years, where they may have greater financial constraints, to later years. The market risks are also shifted on to the authors from the better-diversified publishers. The system also promotes a negative insurance, rewarding the more successful authors but provides no fall back for their struggling contemporaries. Nevertheless the literary community routinely uses a royalty system.<sup>xlviii</sup>

Supporters of authors’ rights cite arguments that are also applicable to arrangements for artist. Authors can promote a literary work after publication through ‘book tours’ and ‘writing other successful books’ just as artists can improve upon their reputation and public exposure. Informational asymmetries exist on both sides as authors know better than their publisher their drive to write other works where as publishers may have better information on a book’s marketability as well as publishing and promotional costs involved. Authors can signal their intentions through taking a payment in royalties and this system can limit the publishers’ informational advantage when negotiating the authors advance. Where there is a fixed royalty rate the ‘publisher must simply decide for itself whether he book is worth publishing *given* the customary rate.’<sup>xlix</sup>

There are obvious comparisons here to artists exhibiting in galleries before the gallery sells on taking a standard rate commission. Once the work is on the market it is presumed that any informational advantage a gallery may possess are lost as prices begin to reflect market evaluations.

The role of galleries is also seen as a mitigating factor as the competitive bidding process for works is not paralleled in the literary market. In an auction approach the publisher would have to bid something close to what they see as the market value, this can be done for visual art, as assessment is straightforward. In the literary market this approach is inefficient, as numerous publishers would have to assess manuscripts in their entirety with only a small possibility that they will secure the publishing rights. For this reason competitive bidding only occurs for the most prominent authors where the potential rewards are the greatest.

The markets for goods in different sectors of the arts also differ to large extent. A noticeable difference is that there is no significant resale market for individual manuscripts for authors or composers. A closer analogy to artists' resale rights exists when rights to a book are sold to a secondary publisher. In this case the royalty arrangement often is maintained with the same percentage terms, as other arrangements would be more costly due to the negotiation process. If a fixed sum had been agreed to pay off an author when switching publishers then the following would take place. 'The publisher would have an incentive to engage in such a resale proceeds exceeds his after royalty profit from continuing to publish himself and vice versa' and an author likewise has a veto power to avoid sales where his revenues are reduced.<sup>1</sup>

There is also an analogy relating to the incomplete nature of the work. The author often negotiates the advance before the final version of the manuscript is completed just as artists strike deals with dealers for present and future output. In both situations an agreement for royalties over a flat fee negates the risk of shirking with lower quality later works.

## **Chapter 4 Impact on the Market**

### **4.1.1 Public Choice.**

The assessment of *droit de suite* legislation requires the use of public choice analysis (also referred to as the economic theory of legislation.)<sup>li</sup> The principal consideration here is the application of game theory and microeconomics analysis to production of law by the legislature.

In particular I will focus here on the law-as-market version of the economic theory of legislation, which asserts that legislation is a good, and so has a supply and demand function just like any other commodity. Following this reasoning protection through legislation ‘flows to those who derive the greatest value from it, regardless of social welfare.’<sup>lii</sup>

#### **4.1.2 Influences on Legislators**

The legislature use regulations ‘to raise the welfare of the more influential pressure groups.’<sup>liii</sup> In this case the pressure is exerted from member states as well as interest groups and opinions from certain states such as France and the United Kingdom whose viewpoints are diametrically opposed. Member States, in turn, are required to balance the interests of artists and the art market.

Member States’ economic interests differ; the United Kingdom for example is a primarily selling country as London is a centre of the international art trade. It is not surprising that the UK has incentives to attach greater importance to protecting the interests of the sellers of works of art than to protecting the rights of the authors. The primary motivation is to maximised revenues from the international auction houses as this increases tax income and indirectly increased possibility of re-election for the incumbent Government. Other states are seen more as production centres and want to help artist. Also a rich culture has secondary benefits as it can help attract visitors, bolstering tourism, a multibillion Euro industry, and can encourage economic migrants to settle and invest in certain metropolitan areas.

Legal traditions also have a certain impact as common law countries have often conceived the objective of copyright to promote art for the public good where as civil law primarily focuses on the protection of creators.<sup>liv</sup>

#### **4.2.1 Development of the Directive through the EU process**

As views differ to such an extreme the European Commission has had to come to a legislative compromise which may or may not be in the public interest but stems from the belief that in seeking a middle ground ‘is the most effective strategy politicians have for maximising political support.’<sup>lv</sup>

The Commission created a proposal in 1996 and the digressive percentage scale that is applicable to secondary sales has subsequently altered (see table below) and it is clear that changes have been substantial.

<b>Price Level</b>	<b>Percentage Applied</b>	<b>Maximum Royalty from this Level</b>
1,000 – 50,000	4%	1960
50,000.01 – 250,000	3%	6000
250,000 +	2%	-----
<b>Total</b>		<b>No limit</b>

The progression of the *droit de suite* legislation through the decision-making process has highlighted a difference in emphasis between the European Parliament and the European Commission. Parliamentary amendment proposals included a far lower threshold of 500 Euros which would have favoured less successful artists to the detriment of sellers and considered that the artist should have a right to a percentage of the profit of any resale rather than the net sale price. This approach follows the theory of intrinsic value theory stating that as artists are the creator of the work and are the sole contributor to any rise in value then they should receive a percentage<sup>lvi</sup>.

Critics have dismissed this approach because of the complexity of calculating and enforcing the rate and use the defunct Italian regulatory system as an example of the impracticalities can be encountered. Other alterations by the Commission from their original proposal include the creation of the limit for the total sum that a seller is required to pay and the increase in the threshold from which the fee applies from 1000 Euro. Considering the previous theoretical example of the Tracy Emin photograph the amount payable has fallen from 6760 Euros and as the realised prices rise the changes are more acute. If DeKooning’s ‘Interchange’ had been sold under this original proposal then the artist would have received approximately 400,000 Euros, considerably higher than the maximum royalty payable under the final Directive of 12,500 Euros.

#### **4.2.2. 'Forum Shopping' – Impact of a Digressive Scale of Royalty Rate**

A frequently voiced criticism of the introduction of a royalty system based around a *droit de suite* is that the costs imposed upon the sellers are so severe that there are sufficient incentives to transfer the sale to a third country where no such costs exist.<sup>lvii</sup> Due to the international mobility of clientele associated with the modern art market there may be the possibility to 'forum shop' and conduct sales in the jurisdiction with the most favourable economic conditions for the stakeholders concerned.

An example provided by the European Commission from 1988 was of the sale three Joseph Beuys paintings in a London auction house for £462 000. Both parties to the sale were German nationals and the Commission appears to suggest that circumvention of the German resale right was a decisive factor in the decision not to conduct the sale in their home state.<sup>lviii</sup>

The displacement of sales to locations where transaction costs are lowest may result in the loss of a competitive edge for European states against third countries. The concern is particularly acute in London, as sales in the city now constitute 70% of the European Art Market with revenue estimates between £2.2-3.2 billion.<sup>lix</sup> The actual sales in London are even higher as it is estimated that between 55-60% of transfers of artistic works in the capital are outside the auction system and sold through professional dealers.

Alongside London the two foremost centres for trade in art are Geneva and New York neither of whom at present operate a resale right system. Transaction costs are difficult to calculate because of the number of factors involved but Catherine Trautmann has stated that considering the tax regimes in place in 1999 costs will amount to 22,000 Euros to sell a work in Switzerland or 33,000 Euros to ship to the United States. Clearly from this simplified standpoint the maximum royalty payment of 12,500 Euros will not encourage migration of sales to third countries.<sup>lx</sup>

The Commission acknowledges that an international resale royalty system would be preferable and endeavour to promote the resale royalty to their principal trading partners. The USA has stated in the past that it would have to consider the enactment of *droit de suite* legislation at the federal level if the EC directive was passed.<sup>lxi</sup> The Swiss Government has contemplated *droit de suite* legislation but no progress has been made since the rejection of the proposal on economic grounds in 1993<sup>lxii</sup>.

The trade-off between circumvention of royalty requirements and the cost of reallocation clearly alters dependant on the expected sale price. Where works are highly valued then the potential savings from avoiding resale payment can become substantial and the agents involved in the sale are more likely to be internationally mobile<sup>lxiii</sup>.

The digressive scale of applicable royalty rates is specifically designed to avoid the loss of large-scale sales from within the member states. The levels have been calculated to ensure that it is not worthwhile for the sale of any artistic works to be reallocated to third countries with the accompanying costs of exporting the piece outside of the European Union<sup>lxiv</sup> but it will take time to assess the effect of this system.

#### **4.3 Art Dealers' Commissions – The Primary Market**

A large majority of visual artists already use a royalty-based division of income with regards to the primary sale of a work and it is useful here to see how this could be expanded into the secondary market. There is no singular method of sale that is sanctioned by statute and yet the market practice is almost universally identical suggesting that it is the most efficient arrangement for the artist and dealer. The artist transfers possession of their work to the dealer who then attempts to sell it onto a collector and both parties will take a predetermined share of the sale price. The alternative arrangement, where the artist sells the work to the dealer who in turn sells on to the general public, is uncommon.<sup>lxv</sup>

The agreement between the artist and the dealer will often extend to grant the dealer the right of exclusive promoter over subsequent works. In this way the dealers have incentives not only to achieve the highest possible revenue from the particular piece in their possession but also to create an appropriate price structure to facilitate the sale of as much of the artist's catalogue as possible. The dealer will have to consider a trade off between sale price of individual works and the quantity of total works sold in order to maximise overall revenue.

The functions of the dealer will principally include the promotion and public exposure of the artist's work and such activities will hopefully raise the value of all the works by that artist. When the dealers have rights to all of the works then the benefits of their promotion are fully internalised and so reach an efficient level. Otherwise there are positive externalities as

others benefit from increase in value of the artistic pieces they are attempting to sell purely because of the dealer's efforts to raise the artist's profile. The dealer therefore can capture a greater share of the returns for his promotional efforts, and thus give gives him stronger incentive to promote the work.

In any arrangement of exclusivity there will always be a danger of abuse of monopoly power. In this situation this is mitigated by the royalty arrangement. Where the artist sells outright to a dealer then a bilateral monopoly is created and if they are guaranteed that future works will be purchased then there is no incentive to create work of a high quality if this requires increased effort as the fee will be paid regardless. The dealer, as an exclusive agent, can also exert monopsony power to only pay a small sum for the artist's future works if no price was agreed as part of the contract.

How far do these concerns penetrate the secondary market?

Contracts binding the parties to multiple purchases of an artist's work will only usually exist in the primary market as collectors reselling work in the secondary market will not usually have such a connection to the artist. The Karp and Perloff model<sup>lxvi</sup> states that given the choice both parties prefer the artist to take a share of the gross or net proceeds rather than to sell to the dealer at a fixed price and the dealer retains the full fee of the public sale. The exclusive arrangement reduces the dealer's incentive to charge the buyer an ineffectively high price 'that reduces the quantity of the artist's work sold below the level that would maximise either the artist's income or the artist's and dealer's joint profits.'

Despite their assertions to the contrary Karp and Perloff's model does not appear to extend to resales as a collector will often own only one of the artist's works. The collector can apply monopoly pricing as he does not have to consider the 'trade off between the price he charges and the quantity he sells.'

Legislation for royalties is only required for resales as the work is no longer possessed by the dealer or the artist and the artist has no way of entering into a contract with subsequent purchasers.

#### **4.4 Effect on the European Union Internal Market.**

To recap, the justification for the European Commission enacting Directive 2001/84/EC is two fold; to remove distortions in the internal market and to remedy the unequal treatment of artists between the different member states. The European Commission considered that EC legislation was necessary, as the member states had failed to reach consensus on removal of existing *droit de suite* provisions and harmonisation would be the second best response.

The Commission asserted that this would not be overly complex as eleven states already operated such systems but as previously stated only five states have actually put enforced a resale royalty right requirement. Any distortions in the market causing competitive disadvantage are only occurring only because of the continuation of such provisions by this minority of EU member states.

The Commission has tried to create a system that rewards artists but does not cause sellers to be burdened with sufficient costs so that they have incentive to conduct the transaction outside of the European Union. Why does the Commission not consider that this is possible on the national level? Member states profit by sales being conducted in their jurisdiction through increased tax revenues and have the political incentive to reward artists and so there are incentives to balance these interests.

The efficiency gains of competing jurisdictions then comes into play as states attempt to reduce the marginal costs that must be borne by intermediaries, particularly auction houses, to attempt to extract the largest possible proportion of sales in the international art market. The member states can then amend their laws as they see fit in response to market forces. Alterations at the EC level would be more difficult due to the complexity of then amendment procedure, especially as this is not conducted by an external body but the commission itself. The concern is that this new harmonised approach will not be sufficiently responsive to market forces and the displacement of sales to the third countries will be followed by more destructive long-term effects. As sales figures diminish the European art centres will lose the expertise and infrastructure that provided them with the status of leading centres for modern art and even if the legislation is repealed the damage maybe irreversible.<sup>lxvii</sup>

The concern for the European Commission is that allowing the jurisdictions to compete in this area facilitates the risk of an abuse of market power. Whilst Member States seek to compete for market share and maximise tax revenues then ‘private actors are free to play

states off against each other’ and result in a ‘race to the bottom.’<sup>lxviii</sup> The influence and political leverage of the major international auction houses may imbalance the trade off between the interests of artists and sellers unfairly towards the benefit of the latter.

Auction houses may see the *droit de suite* not as a factor for the quantity of sales just where they the sales are located.<sup>lxix</sup> Member States begin to offer increasingly favourable conditions to intermediaries to ensure that they conduct business in their jurisdiction but in doing so ignore the plight of the underrepresented artists. When the California Resale Right legislation was enacted in 1976<sup>lxx</sup> Sotheby’s ceased to conduct operations from Los Angeles was seen as a threat to Washington not to consider such provisions on a federal level rather than based on economic considerations. Therefore the commission maintains co-operation between states is necessary to ensure a minimum level of protection of artists. If this is the case then this is a convincing argument for minimum levels of resale royalty to be set but not an entire rigid scale. A system could be set up that is analogous to the VAT directive<sup>lxxi</sup> where Member States are required to charge a tax rate of 15% but are free to amend upwards (as shown by Denmark where VAT is levied at 25%.)<sup>lxxii</sup>

A precise calculation may be necessary to simultaneously maintain protection for artists and the competitiveness of Europe with the global economy<sup>lxxiii</sup> but there is no indication that this cannot be done on the national level.

#### **4.5 Wider Picture – State Sponsorship**

The assumption by the European Commissions is that the harmonisation of provisions relating to the resale royalties of artists will end the inequality of the treatment of living artists in the different member states. While the existence or non-existence of *droit de suite* provisions is a highly visible difference between national laws this does not mean other variations do not exist.

Any attempt to achieve equal treatment of artists will essentially be seeking the ‘uniform promotion of artistic creativity.’ Financial incentives for the creative arts are diverse and widespread ranging from subsidies and state commissions to prestigious competitions such as the Turner Prize. Sponsorship may come directly from the state through a government ministry or through charitable funds. Governments of the Member States will treat the

creative arts with differing degrees of priority. It is an open question as to whether the objective of uniform promotion is beneficial, particularly from the EU level.

The promotion of culture is of prime importance to certain states and they have other ways of supporting their artists such as welfare funds that may more accurately provide for those most in need. If the benevolence of member states differ then artists may still be subject to differing treatment depending on their place of residence and nationality within the European Union. The impact of any new legislation on cultural diversity within the Union has to be considered very seriously in order to ensure that regional cultures are respected following Article 151(4) of the EC Treaty.<sup>lxxiv</sup> The Commission operates under the remit of establishment and functioning of the internal market when enacting harmonisation of copyright provisions and they cannot be too broad with their interpretation of their responsibilities.<sup>lxxv</sup>

#### **4.6 Impact on the International Art Market**

Supporters and critics of *droit de suite* legislation have both relied upon arguments relating to the effect on the international trade in the art market. The situation is therefore obviously not clear-cut, as many factors have to be taken into consideration.

As I have previously stated the majority of contemporary art sales through auction houses take place in London, New York and Geneva, none of which presently operates artists' resale rights. But closer observation shows that these three cities are centres on the art trade in general especially considering works by past masters that are not the focus of *droit de suite* legislation in any nation state. Other factors must be at work here as the royalty requirements are the same.

Modern Art is big business but still only constitutes a small percentage of overall sales for the leading auction houses. The influence of modern art sales on Christie's total turnover between 1989 and 1993 ranged from just 5.6% to 9% and only 6% of Sotheby's sales in 1994 were works of contemporary art.<sup>lxxvi</sup> Therefore it is unlikely that any displacement of sales of modern art to these centres from countries with resale royalty regimes will have caused a corresponding migration of sales of older works. There has been critique that the European Commission itself and the Ifo Institut who supplied them with the background

information on royalty systems followed such an oversimplified assumption about the effect on the displacement of sales. Unfortunately the lack of empirical evidence in this area was all too apparent.<sup>lxxvii</sup> The general distribution of sales of artwork is therefore unlikely to be an indirect result of the imposition of *droit de suite* legislation. The more likely scenario is that modern art sales are attracted to centre for the sales of other works.

The basic evidence from the IFO Institut is clear, if a modern art piece was sold for a particular price then the seller would take greatest profits in the United Kingdom and the Netherlands as only sale tax was payable from the seller's takings. All economic actors in the art market, whether the artist, the private collector or the intermediaries such as the auction houses will take the tax burden they expect to face into consideration. In Germany, France, Belgium and Denmark the seller would have to deduct a percentage under the *droit de suite* legislation to provide to the creator. The private sellers in France also have to deduct the payment of capital gains tax.<sup>lxxviii</sup> All companies involved in trading art will have to consider differences in corporation tax that can still be substantial regardless of the EC objective to harmonise provisions of capital.<sup>lxxix</sup>

Where the seller may only be subject to sales tax then it must be borne in mind that although the European Union has set a minimum base rate of 15% countries are allowed to raise this level. Denmark for example has a value added tax rate of 25% of to help fund their extensive welfare state. The wide variation in VAT rates would be expected to have a greater distortive effect on competition than the *droit de suite*.<sup>lxxx</sup> There is a possibility that the *droit de suite* is only being harmonised because it is a more obvious difference in costs of selling art where as there are actually several other more indirect but just as significant barriers to entirely fair competition between EU artists.

A large assumption is that the same price can actually be achieved across the European community. Any analysis has to consider the relative influences of all the economic actors especially the intermediaries such as auction houses and art dealers. Non-fiscal factors can significantly contribute to differing volumes of sales between Member states and undermine several of the justifications provided for the recent directive by the commission. Firstly the seller will be looking for the maximum audience of potential buyers when their piece is sold on. The United States of America has the largest number of investors in modern art and so it comes as no surprise that there is the greatest number of sales<sup>lxxxi</sup>.

An important aspect of the role of intermediaries is to assemble the widest possible of high quality pieces to attract the most distinguished buyers. Auction houses have established reputations of amassing ‘a good lot’ in particular areas of art. When a reputation can be established the buyers can begin to develop a relationship of trust with the auction house as they are more confident of the value of the work they are investing in and so with a lower degree of risk aversion are willing to raise their potential purchase price.

The consideration of risk bearing within the art market is a difficult concept, as the customer often does not fit the profile of a typical consumer. Traditional economic analysis assumes the sellers to be risk neutral and the buyers risk averse. However the art market differs as it consists in a trade of unique rather than mass-produced items. Authenticity is essential to the valuation of an artistic work but this market sector, more than other, has an advanced system of verification of the genuine nature of the work. When a buyer desires a particular style of work or seeks to acquire a piece by a particular artist then it is less likely that if the price rises above what they expected to pay then they can readily seek a substitute work. The higher the value of the work and the greater the prestige of the author the more inelastic the demand function of the potential purchaser. Therefore when dealing with expensive works it has been predicted that a deduction of the proportion of the *droit de suite* is unlikely to switch consumer preference to works for which the right does not apply or to differing forms of investment altogether.<sup>lxxxii</sup>

New York is highly reputed for auctions of modern art, as is Cologne,<sup>lxxxiii</sup> where as London focuses on sales of the old masters. These international cities of the art trade become known as centres with a developed pool of experts and specialised services relating to working with certain niche sectors of the art market. Traders in art will be encouraged to buy and sell in places where a ‘pool of persons’ is available to provide valuations, advice and specialised services in that particular area of modern art.

The sale of major works often attracts a significant degree of publicity and the price achieved is integral to the attention the auction receives. Private collectors, and galleries to a limited degree, may well see the purchase of a valuable artistic piece as a significant status symbol. Therefore the buyers may not only be price insensitive but also actually prefer higher prices as a sign of social rank. Purchasers may be interpreted as risk neutral because the potential

future resale loss is counterbalanced by a utility premium of society being aware that the individual owns an extravagantly priced but famous artistic work. The buyer may be using the public purchase of expensive goods as a signal to competitors or rivals of their spending power and the price tag may actually be seen as an asset to the piece rather than a cost.<sup>lxxxiv</sup> Within certain sectors of the art market there may be the perverse result that high prices actually stimulate greater demand. The highly specialised nature of the global art world means that legal and fiscal factors will compete with considerations of the skills of the sales staff and tradition.

The nature of fashion and trends dictates that certain styles of art and particular artists will be more popular in certain areas of the world than others. The art dealer will therefore need to consider whether to attempt to sell in a particular geographical area because of a particularly large ratio of interest to overall wealth. For example there may be a higher demand for a particular style in Germany which means that the greater willingness to pay for German buyers over other national exceed the losses to the seller of deducting a resale royalty. Indeed the premium gained from selling in a country where the style of the piece is in high demand may allow the seller to pass the royalty costs onto the seller.

#### **4.7 Alternatives**

Commentators have suggested other methods to the resale right by which artists could ensure that they still profit from their own popularity but when compared to the *droit de suite* they appear fraught with difficulties. An artist could either simply increase production when prices of their work begin to increase or to retain or rent works from earlier creative periods and so when they begin to receive attention for their output they can profit from the increase in prices of the back catalogue by releasing a contemporary piece.

The artist would require a fair degree of skill to be able to take such a long term perspective on their work and by holding works off the market may enable future profits but the positive effect on reputation of releasing the work immediately is lost. The key advantage of the resale right is the continuing interest in the market value of a piece throughout the lifetime of the artist. The artists can retain a stake in a diverse range of works from all stages of their career without having to limit their distribution to the public.

The most important analysis of the *droit de suite* is to determine whether benefits of the legislation outweigh the accompanying costs. Existing legal regimes are not particularly useful in this regard as they have encountered numerous problems and have many shortcomings. There is the possibility to remedy the problem of imperfect capital markets, which are seen as a barrier to receiving commercial financial assistance, through government loans at preferential rates as is done to great success for UK University Students. There is a very similar analogy between students and artists as both have great earning potential but may be hindered by financial problems early in their career. An ideal solution is subsidies provided in a way that is not considered to distort the market.

An alternative proposal is to consider an approach closer to copyright of dramatic works where the author receives royalties based upon the number of individual performances of their piece.<sup>lxxxv</sup> Under this model the artist would maintain a right to display even after possession of the physical item has been transferred. An example of a measure of the royalty has been suggested as the total viewership of the work and such an exhibition or display right and may fit better into a copyright regime than a resale right.

No jurisdiction has been noted to apply such a system and this may well be because the complexity of the necessary administration has not been seen to be justifying the efficiency gains. Other royalty systems such as music performances and radio airplay are already well established despite their relative complexity. The system would be of less value to a visual artist as there is only one original of the work unlike performance rights to use for DVDs and such like.

Display royalties could help to provide incentives for the artist to enhance their general reputation and therefore the value of their previous work as they stand to benefit from a greater internalisation of their craft. The artist will have a greater control over their reputation if they have some say in where the work is displayed and, in general, will try to achieve greater exposure. If there is a genuine concern for the economic hardship of artists and that the present system does not provide the correct incentives then alternatives such as those mentioned need to be explored further.

## **5. Conclusion**

The merits and pitfalls of introducing legislation for resale royalties clearly represent a complex and controversial issue. The Commission obviously intends to assist artists and the market has to bear these costs but it cannot be said with any conviction that Directive 2001/84/EC even helps the intended beneficiaries. After the harmonisation of VAT charges the existence or non-existence of a *droit de suite* provision is one of the most obvious differences in applicable charges on secondary sales of works of art between Member States. If the resale royalty constitutes a barrier to trade then it should be removed not enforced upon all members of the Union.

Through the desire to satisfy all concerned parties the Commission has compromised the effectiveness of the legislation, as it no longer serves those for whom it was designed. The threshold level is so high and the percentage of works that are resold is so small the number of artists who will benefit is minimal. Further more the resale right has closer similarities to a rental charge than a moral right. The principal factor in the quantity received is actually how many times the paintings are sold on rather than their appreciation in value because the royalty is a percentage of the net price and not the profit gained. The number of times an artistic work is resold is a highly stochastic event and there is every opportunity that the original purchaser will retain valuable works.

As this legislation is now in place it will be difficult to repeal due to the accompanying costs of the removal of continuing property rights once they have been granted. The harm on the market should be minimal however as the royalty threshold is just a marginal cost for the most expensive works for which displacement of sales to third countries may have increased profit margins under the original proposals.

There are no proven alternatives that can provide reimbursement to artists as well as provide the incentives to maintain reputation that come with the resale royalty. However the EC Directive only applies to wealthier artists to whom the concerns of insufficient capital and lack of market for reproductions do not apply. The policy goals of the European Commission are justified but further consideration is necessary to look for a system that provides for the visual arts as a profession rather than the successful elite.

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<sup>i</sup> *Proposal for a European Parliament and Council Directive on the Resale Right for the Benefit of the Author of an Original Work of Art*, Explanatory Memorandum, COM(96) 97 at 2. All following references relate to the 2001 Directive rather than the 1996 Proposal.

<sup>ii</sup> Also referred to as the artists' resale right, art proceeds right and the follow-up right.

<sup>iii</sup> Liliane Pierredon-Fawcett, *The Droit de suite* in *Literary and Artistic Property*, 1-4 (1991)

<sup>iv</sup> The ifo Institut found that only in five countries of the Union (Germany, France, Belgium, Spain and Denmark) is the *droit de suite* collected regularly. See Becker [1995] *Droit de Suite: Report Commissioned by the French Authors' Society ADAGP, The German Authors' BILD-KUNST and the Groupment Européen de Sociétés d'Auteurs et Compositeurs (GESAC)*, ifo studien zu kultur und wirtschaft 15 (ifo Institut für Wirtschaftsforschung.) Hereafter referred to as the 'Ifo Report.' This work was used as primary source by the Commission when initially drafting the Directive Proposal.

<sup>v</sup> The European Community in its external has set itself the task of negotiating with third countries to attempt to make Article 14B of the Berne Convention compulsory world-wide. Explained in Directive 2001/84/EC at Explanatory Memorandum at 7. (Here after simply referred to as 'Explanatory Memorandum')

<sup>vi</sup> Joined Cases C-92/92 and C-326/92 *Collins v. Imtrat Handelsgesellschaft mbH and Patricia Im-und Export Verwaltungsgesellschaft mbH and Leif Emanuel Kraul v. EMI Electrola GmbH* [1993] ECR 545. See explanatory memorandum at 6.

<sup>vii</sup> For further background information relating to this section see Gramp, W D. [1989] *Pricing the Priceless*. Basic Books and Reitlinger [1961] *The Economics of Taste*. London: Barrie and Rockcliff,

<sup>viii</sup> For further information please consult Mainardi [1993] *The End of the Salon, Art and the State in the Early Third Republic*. Cambridge University Press

<sup>ix</sup> see Booton, David, *A Critical Analysis of the European Commission's Proposal for a Directive Harmonising the Droit de Suite* [1998] 2 *Intellectual Property Quarterly*:165-191

<sup>x</sup> see Filer, Randall K. 1986 *The "Starving Artist" - Myth or Reality? Earnings of Artists in the United States* *The Journal of Political Economy*, Vol. 94, No.1: 56-75 where the present economic situation of artists from the USA is discussed. The article concludes that incomes of artists are only marginally lower than comparable occupations.

<sup>xi</sup> Directive 2001/84/EC of the European Parliament and of the Council of 27 September 2001 on the resale right for the benefit of the author of an original work of art.

<sup>xii</sup> Explanatory Memorandum at 10.

<sup>xiii</sup> Steiner, "Subsidiarity under Maastricht" in O'Keefe and Twomey (eds), *Legal Issues of the Maastricht Treaty* (Wiley Chancery Law, 1994), at 58.

<sup>xiv</sup> The Commission states that it has complied with the principles of proportionality and subsidiarity in the Explanatory Memorandum at 16

<sup>xv</sup> see Explanatory Memorandum at 15

<sup>xvi</sup> Explanatory Memorandum at 9.

<sup>xvii</sup> Directive Proposal (1996) Explanatory Memorandum, at 19.

<sup>xviii</sup> *Proposal for a European Parliament and Council Directive on the Resale Right for the Benefit of the Author of an Original Work of Art*, Explanatory Memorandum, COM(96) 97 at 19

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<sup>xix</sup> The European Commission has to promote the international competitiveness of companies within European Union, see Commission White Paper on Growth, Competitiveness, and Employment [1993] *The Challenges and Ways Forward into the 21st Century*, COM(93) 700 final.

<sup>xx</sup> Macey J. R. [1998] *Public Choice*. in *The New Palgrave Dictionary of Economics and the Law* 171-178 at 172

<sup>xxi</sup> The definition of ‘original works of art’ for the purposes of this legislation is given in Article 2(1) of the Directive.

<sup>xxii</sup> Article 8 (1) of the Directive, provides the artist with the same duration of protection afforded through copyright following Directive 93/98/EEC

<sup>xxiii</sup> Explanatory Memorandum at 3

<sup>xxiv</sup> Article 3(1) and 3(2) of the directive

<sup>xxv</sup> Article 1 (2) of the Directive

<sup>xxvi</sup> Article 1 (3)

<sup>xxvii</sup> Article 4 of the Directive

<sup>xxviii</sup> see Explanatory memorandum at 25

<sup>xxix</sup> see Explanatory memorandum at 1

<sup>xxx</sup> Jeffrey. C. Wu, “Artist Resale Rights and the Art Resale Market: A Follow-up Study,” 46 *J. of Copyright Soc. of the USA* (1999)

<sup>xxxi</sup> McAndrew, Clare and Dallas-Conte, Lorna *Implementing Droit de Suite (Artists' Resale Right) in England*.

<sup>xxxii</sup> As testified by Jean-Marc Gutton, General Manager of ADAGP (Association pour la Diffusion des Arts Graphiques et Plastiques) see Michael B. Reddy [1995] *The Droit De Suite: Why American Fine Artists Should Have The Right To A Resale Royalty*. *Loyola of Los Angeles Entertainment Law Journal*: 509-545 at 531

<sup>xxxiii</sup> Smedley, Bunny [2001] *European Journal* 8(7): 22-24 at 22

<sup>xxxiv</sup> Of the numerous useful references for reputation analysis in the art world see in particular, Solow, John [1998] *An Economic Analysis of the Droit de Suite* *Journal of Cultural Economics* 22 (4): 209 -226, 1998

<sup>xxxv</sup> see Akerlof G.A. [1970] The Market for ‘lemons’: quality, uncertainty and the market mechanism. *Quarterly Journal of Economics* 84: 488-500

<sup>xxxvi</sup> see Hansmann and Santilli. Royalties for Artists versus Royalties for Authors and Composers. *Journal of Cultural Economics* 25 (4): 259-281 at 264

<sup>xxxvii</sup> Hansmann and Santilli at 264

<sup>xxxviii</sup> Hansmann and Santilli at 264

<sup>xxxix</sup> see in particular Radin, Margaret Jane [1987] Article: Market-Inalienability, *Harvard Law Review* 100: 1849-1937, Epstein, Richard A, [1985] Symposium on Law and Economics: Why Restrain Alienation?. 85 *Columbia Law. Review* 970-90 and Rose-Ackermann, Susan [1998] *Inalienability*. *The New Palgrave Dictionary of Economics and the Law*

<sup>xl</sup> see Schäfer/Ott, *Ökonomische Analyse des Zivilrechts* (3. Aufl.) available at <http://www2.jura.uni-hamburg.de/le/index.htm>

<sup>xli</sup> Michael B. Reddy [1995] at 531

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<sup>xlii</sup> The relationship between rights of distribution, lending rights and the *droit de suite* is considered by Ricketson, *The Berne Convention for the Protection of literary and artistic works: 1886-1986* (Kluwer, 1987) at 400-402.

<sup>xliii</sup> Schafer / Ott *ibid.*

<sup>xliv</sup> Posner R. 1982. 'Economics, politics and the reading of statutes and the constitution. *Univ. of Chicago Law Review* 19: 211-40

<sup>xlv</sup> Calabresi. G and Melahmed. D. [1972] Property rights, liability rules and inalienability rules: on view of the cathedral. *Harvard Law Review* 85: 1089-1128

<sup>xlvi</sup> Rose-Ackermann, S. 1985. Inalienability and the theory of property rights. *Columbia Law Review* 85: 931-69

<sup>xlvii</sup> John Henry Merryman, Albert Edward Elsen, *Law, ethics, and the visual arts* [2002] 4th ed. - London: Kluwer Law International 2002 at 500

<sup>xlviii</sup> see Hansmann and Santilli. *ibid.*

<sup>xlix</sup> Hansmann and Santilli at 270-272

<sup>l</sup> Hansmann and Santilli at 271

<sup>li</sup> Macey J. R. at 171

<sup>lii</sup> Posner R. 1982. *ibid*

<sup>liii</sup> Becker, G [1985] *Pressure Groups and political behaviour. In Capitalism and Democracy: Schumpeter Revisited*, ed. Richard D. Coe and Charles K. Wilber, Notre Dame: University of Notre Dame Press

<sup>liv</sup> Booton, David at 170

<sup>lv</sup> Macey, J.R. at 172

<sup>lvi</sup> see de Pierredon-Fawcett, *op. cit.*, at 10-20.

<sup>lvii</sup> The British Art Market 1997; A Study of the Value of the Art and Antique Market in Britain, and the Implication of EU Harmonisation of Import VAT and Artist's resale rights, prepared for the British Art Market Federation by Market Tracking International Ltd at 8.

<sup>lviii</sup> IFO Report. at 14.

<sup>lix</sup> Smedley, Bunny,. at 22

<sup>lx</sup> Smedley, Bunny, at 22

<sup>lxi</sup> See Damich, "Moral Rights Protection and Resale Royalties for Visual Art in the United States: Development and Current Status" [1994] 12 *Cardozo Arts & Entertainment Law Journal* 387, at 406.

<sup>lxii</sup> ifo Report, at 25-26.

<sup>lxiii</sup> see Moulin, *The French Art Market. A Sociological View* (Rutgers University Press, 1967), at 32.

<sup>lxiv</sup> For further explanation of the position of Third Country Nationals in relation to the directive refer to Article 7

<sup>lxv</sup> Hansmann and Santilli, at 266

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<sup>lxvi</sup> Karp L. and Perloff J [1993] Legal Requirements that Artists Receive Royalties. *International Review of Law and Economics* 13: 163-177

<sup>lxvii</sup> Loss of expertise as a consequence of this type of legislation is discussed in more detail in Smith, “*British Art Market Fears Collapse Under EU Tax Burden*,” Reuters/Variety 30 June 1997. Extracted in Booton, *ibid*.

<sup>lxviii</sup> Booton, *ibid*.

<sup>lxix</sup> The Earl of Gowrie, a director of an auction house, commented that “this is not an issue that is going to affect the auction houses themselves, simply the locations in which they conduct their business.” Lords Hansard 1 April 1996, at 8-9.

<sup>lxx</sup> see John Henry Merryman, Albert E(dward) Elsen at 479

<sup>lxxi</sup> Sixth Council Directive (77/388/EEC) of May 1977 harmonising turnover taxes, last amended by Directive 1999/85/EC (O.J. 277, 28/10/1999, p34,) see Explanatory Memorandum, at 12.

<sup>lxxii</sup> See in particular Beveridge and Riley, “The Tax Goals of the EC” in Howells, *European Business Law*, (Dartmouth, 1996), at 157-159.

<sup>lxxiii</sup> Explanatory Memorandum, at 8

<sup>lxxiv</sup> see Explanatory memorandum at 5

<sup>lxxv</sup> Conclusions of the Ministers for Culture Meeting within the Council of 7 June 1991 on copyright and neighbouring rights, [1991] O.J. C188/4, at 4.

<sup>lxxvi</sup> Ifo Report, at 91.

<sup>lxxvii</sup> Booton, *ibid*

<sup>lxxviii</sup> ifo Report, at 79.

<sup>lxxix</sup> Business taxation has been highlighted as warranting particular attention and following discussion at an ECOFIN meeting on 1 December 1997, the Council and the Representatives of the Governments of the Member States, meeting within the Council, agreed to the Resolution on a code of conduct for business taxation: see Council Press Release PRES/97/365, 5 December 1997.

<sup>lxxx</sup> ifo Report, at 60.

<sup>lxxxi</sup> 50% of buyers on the global market are from the United States of America. Followed by Japan with 25% and Europe with 20%: *ibid.*, at 4.

<sup>lxxxii</sup> *Ibid.*, at 35.

<sup>lxxxiii</sup> *Ibid.*, at 107 and 113.

<sup>lxxxiv</sup> Moulin, at 86-88.

<sup>lxxxv</sup> considered in particular in Santaga, Walter [1995] Institutional Anomalies in the Contemporary Art Market *Journal of Cultural Economics* 19: 187-197 and William A. Carleton [1991] *Copyright Royalties for Visual Artists: A Display-Based Alternative to the Droit de Suite* Cornell L.R. 76: 510-548

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