VISUAL ARTISTS' RIGHTS ACT OF 1987: A CASE OF MISGUIDED LEGISLATION

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Introduction

Since the middle of the 1970s, what Dempsey (1935) would have called a vulgarization of the concept of just price has become popular in artistic circles in the United States. Indeed, this just price variation has already taken the form of a statute which has been in effect in California since 1976 and which more recently as been proposed as federal law by Senator Edward Kennedy and Representative Edward Markey. The Kennedy-Markey bill amends the copyright law to secure the rights of authors of pictorial, graphic, or sculptural works (i.e., artists) to prevent the distortion, mutilation, or other alteration of such works and to provide for resale royalties for the lifetime of the artist and up to 50 years after his or her death. The right to receive this royalty may not be waived.

While the California statute and the proposed legislation are different in design and economic impact, both imply to an economist the by now unusual idea that in an unconstrained transaction there exists objective value apart from the value in the minds of the buyer and seller. To an attorney, on the other hand, the laws also imply that like children and mental defectives, artists are not competent to alienate property.

The basic premise of both laws is the concept of *droit de suite*, which is usually translated as "right to art proceeds." This idea posits that artists have a right to a portion of the resale value of their art since, for various loosely defined reasons, the artist is unlikely to

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obtain the "true" value of the art at the time the art is originally sold. In both laws the term "art" refers to nonreproducible paintings (or graphics) and sculpture. Either for pragmatic reasons, or because they do not fit into what Price and Price (1972) have called the theology of *droit de suite*, art, as defined by these laws, does not include the work of architects.

As originally formulated, the California statute requires that a royalty of 5 percent of the resale price of a work of art be paid to the artist when the resale takes place within the boundaries of the state of California. The law contains a *de minimis* exemption for gross transactions of less than $1,000 and any gross resale which is less than the original purchase price.

The Kennedy-Markey proposal is analogous to a capital gains tax which requires that a 7 percent royalty be paid on any excess between the resale price and the purchase price. The major exception is for works whose gross resale price is less than $1,000 or 150 percent of the purchase price.

Both laws contain a provision that *prevents* an artist from entering into a contract with a purchaser whereby the artist waives the right to the resale royalty. This prohibition clearly violates the legal maxim that anyone may waive a right asserted in his or her behalf, and it thereby prevents the artist from selling, or alienating, his or her property. It should also be noted that the royalty in both cases is asymmetrical in that the artist is not required to pay the purchaser a refund should the resale price be lower than the price originally paid for the art. This asymmetry clearly reduces the potential gain to a purchaser of art without any offsetting reduction in potential loss.

Finally, it is worth noting that variations of both laws are presently in effect in several European countries. The California statute is akin to the law of France, while the Kennedy-Markey proposal is closer to the law of Italy (see our 1978 paper).

The proximate impetus for importing the European concept of *droit de suite* to the United States comes from the celebrated case of the conflict between investor Robert Scull and artist Robert Rauschenberg. Rauschenberg felt himself wronged by Scull's resale of his painting "Thaw." Scull had purchased Rauschenberg's painting directly from the artist in the 1950s for $800 and resold it at auction 20 years later for $85,000, a return somewhat lower than would have been obtained by an investment in IBM stock over the same time period (see Elsen 1977 and Hochfield 1976, 1977).

Regarding this dispute, one needs to realize two things. First, that the artist benefited by Scull's investent in that the profitable resale of "Thaw" enhanced the value of *all* of Rauschenberg's work, present

and future. Second, that by focusing on one profitable work in a portfolio, one overestimates the return on the entire portfolio, since the vast majority of artwork decreases in value.

Rates of return on traded art are notoriously low, despite the occasional spectacular price for a Van Gogh, Picasso, or Warhol. Baumol (1986) examined resale prices of art works by the most famous painters of the world over a 300-year period and found an annual compounded rate of return of 0.55 percent in real terms with no adjustments for sales commissions, maintenance costs, or risks.

The Benchmark Sell or Invest Decision

Art may be purchased for investment reasons, for consumption reasons, or for a combination of the two. Since both the California and the Kennedy-Markey statutes are directed mainly at the investor, we will limit our analysis to this aspect of art purchasing; after all, it is profitable resale that sets the value for current and future works of an artist. More importantly for our purposes, one almost never sees in the literature that is favorable to *droit de suite* any mention of the fact that artists are perfectly free to invest in their own art. Monet, who lived his early life as an artist in the proverbial garret, was one such investor; Picasso was another. Let us consider the artist as a potential investor in his or her own art who faces a purchaser who is also interested in investing in the particular work of art. We will concentrate on a simple two-period model which is easily transformed into a multiperiod model involving several sales and resales.[1]

To avoid problems with expectations, let us assume that the artist and all potential purchasers are in agreement as to the resale value of the art one period from today, P_1. It is axiomatic that, of all potential purchasers, the individual with the lowest discount rate (the lowest need for present consumption) will offer the highest bid for the art. Let us call this discount rate r_*, which will be used to define the present value of the work of art to this prospective purchaser: $P_1/(1+r_*)$.

If we denote the discount rate of the artist as r_a, then the artist will prefer to sell the work of art whenever the present value of the art to the artist is less than the present value of the art to the potential purchaser. Thus, a sale will take place whenever

$$P_1/(1+r_*) > P_1/(1+r_a), \qquad (1)$$

[1]No generality is lost by our concentration on a two-period model in that the results given below will simply be magnified in multiperiod exchange.

which reduces to

$$r_a > r_*. \tag{2}$$

Equation (2) gives the classic result that the sale will take place if the artist has a greater present need for consumption than the buyer with the least present need for consumption among all prospective buyers. If by use of the term "starving artist" we mean a relatively high value for r_a, then at some future time the artist may retrospectively view the sale with regret when, perhaps because of increased wealth, the artist's need for present consumption falls. In our view this retrospective regret is the source of feelings of unfairness that give rise to *droit de suite*. Notice, however, that no notion of disproportionate "market power" on the part of the buyer is necessary for us to obtain this or any other result to follow. In fact, as McAfee and McMillan (1987) have recently pointed out, from the point of view of a standard English auction, the artist is in reality a monopolist with respect to any single item of nonreproducible art.

The California Statute

Assuming that the art appreciates beyond the *de minimis* point, the California statute levies a royalty of 5 percent upon the resale price of the work at the end of the holding period. If we denote this royalty as t, then the best offer that will be made today for the art by a prospective purchaser is

$$(1-t)P_1/(1+r_*), \tag{3}$$

where $t = 0.05$.

In addition to this offer, the artist will also receive the amount tP_1 (the royalty payment) at the end of the holding period, which will have a discounted worth today to the artist of $tP_1/(1+r_a)$. Now, a sale will take place whenever

$$(1-t)P_1/(1+r_*) \;+\; tP_1(1+r_a) > P_1/(1+r_a). \tag{4}$$

As before, the sale will occur whenever $r_a > r_*$; and when $t = 0$, equation (4) reduces to equation (1) as it should. Note also that when $t = 1$, the entire resale price is returned to the artist and that the leftmost term of equation (4) becomes zero, indicating that the artist will never be able to sell the art to a rational investor.

It is now quite easy to show the basic difficulty of the California statute. The artist will be better off with the statute whenever the left side of equation (4) is greater than the left side of equation (1).

Upon substitution, one immediately finds that this inequality is possible only if

$$r_* > r_a, \tag{5}$$

which is in direct contradiction to equation (2). In short, given the discount rates, the artist will always be worse off with the statute than without it.

The common sense of this finding is simple. The royalty statute prevents the artist from selling the entire work of art, forcing the artist instead to retain a residual interest in it. If the return on this implicit investment is greater than or equal to the discount rate of the artist, then the artist will not be adversely affected by the forced investment. However, the greatest return that the artist can expect to receive from this investment is the discount rate of the purchaser, r_*, which is necessarily less than the discount rate of the artist, r_a. Thus, the artist who wishes to sell the entire work of art will always be adversely affected.

The Kennedy-Markey Statute

Again, let the resale price be P_1 and the purchase price P_0. The capital gain from the resale of the art is the difference between these two prices, $P_1 - P_0$. Then, subject to the *de minimis* provisions, and with the royalty rate $t = 0.07$ for the Kennedy-Markey proposal, the best offer that will be made for the art is

$$P_0 = \frac{P_1 - t(P_1 - P_0)}{1 + r_*} \tag{6}$$

so

$$P_0 = \frac{(1-t)P_1}{1 + r_* - t}.$$

The artist will also receive upon resale a royalty payment whose present value to the artist today is $t(P_1 - P_0)/(1 + r_a)$. Therefore, the sale will take place whenever

$$\frac{(1-t)P_1}{1 + r_* - t} + t(P_1 - P_0)/(1 + r_a) > P_1/(1 + r_a)$$

or

$$(1-r)P_1/(1+r_*-t) + tr_*P_1/(1+r_a)(1+r_*-t) > P_1/(1+r_a). \tag{7}$$

This expression reduces to $r_a(1-t) > r_*(1+t)$ which cannot hold unless $r_a > r_*$. Again, when $t = 0$, equation (7) reduces to equation (1); and

again, when we ask when the left side of equation (7) will be greater than the left side of equation (1), we find that the same contradiction exists as before, namely, that $r_* > r_a$. Therefore, the Kennedy-Markey proposal exhibits the same basic problem as the California statute: it is not in the best interests of the artist.[2]

Who Benefits from Royalty Statutes?

The pressing question about art royalty statutes is why they are advocated at all since both economic theory and common sense predict that the offer price for new art will simply be reduced in a way which is disadvantageous to the artist when the rational buyer takes into account the resale royalty. There is only one class of art whose original sales price will not be reduced by the royalty legislation—art which was sold prior to the legislation. Therefore, the legislation will tend to benefit older more established artists at the expense of younger, less-established ones. The laws provide, in essence, a subsidy to established artists who have a viable resale market for their works, at the expense of unestablished artists.

Unfortunately, artists whose works are in this privileged class are rare indeed. According to the Art Dealers Association, there are only about 50 living artists who have a significant resale market for their work, and almost all art depreciates in value (see Hochfield 1976). Thus, these statutes will benefit only the selected few artists who need protection the least. In addition to established artists, there is a second group of "winners." The Kennedy-Markey bill provides for a federal registration system for "works of fine art." And to determine whether or not a specific work qualifies as art, a court may take into account the opinions of artists, art dealers, collectors of fine art, curators of art museums, restorers and conservators of fine art, and other persons involved with the creation, appreciation, history, or marketing of fine art—in short, the art establishment. Everyone in

[2]As indicated earlier, this analysis is based upon only one resale of the work of art. If the royalty applies for N years and the artwork is traded every τ years, the current price will be

$$P_0 = \left[\frac{(1-t)}{(1+r_*)^\tau - t}\right]^{N/\tau} P_N,$$

where P_N is the value of the work N years hence. This expression shows that the current price is discounted by the royalty rate N/τ times (i.e., each time the work is sold in the N year horizon). Note that P_0 increases when t is decreased (i.e., the larger the royalty, the more the current price is discounted) or when τ is increased. Thus, only by decreasing the art's visibility (e.g., through longer lags between auctions) can the deleterious effect of the royalty be mitigated and even then never completely.

the art community wins but the struggling artist and the risk-taking investor.

Conclusion

The concept of royalties for fine art is derived from a false analogy with the royalties paid to writers and composers whose work is expandable through further production. Yet, fine art by definition is not expandable except by the artist himself. The analogy, therefore, fails.

The economic problems with royalties for fine art have been amply demonstrated by the market itself. A legal instrument which artists may use to contract for royalty payments has been widely available for some time (see the "Projansky Agreement" in Feldman, *et al.* 1986). Artists who are proponents of the statutes reviewed here claim that such agreements cannot be made to work without national legislation. What they really mean is that the agreement cannot be executed at prices which artists find favorable. Legislation will not change this fact because it is inherent in the process of negotiation for fine art.

Although a laudable attempt to help artists in general, the proposed legislation misfires. Because (1) the appreciation in value of art work is "taxed" but there is no relief from a decline in value, and (2) the expected benefits will accrue to only the few artists with a significant resale market for their works while all others will be hurt. Thus, the economic impact of the act is clear. Investment in the work of unknown artists will be dampened and only the few, well-established artists will benefit. This is surely an unintended result of legislation proposed to introduce "fairness" into the art market.

While profitable resale is rare, such resales already substantially benefit artists. Future works as well as those in inventory ("voluntary investment") appreciate in value *pari passu.* With profitable resales, artists such as Rauschenberg should rejoice when an art investor profits from taking risks in their works. "A rising tide lifts all boats" and a rising price for art helps all artists. Legislation is not needed to cause this to happen.

If the definition of property rights is extended to include a residual right in future resales, a right that cannot be waived according to the proposed legislation, artists are prevented from alienating their property—a clear violation of the legal maxim that anyone may waive a right asserted in his or her behalf.

The art royalty statutes are paternalistic, misguided attempts to help artists. They help the few who need help the least; they decrease

the incentive for investment in works of art; they assume that artists are incompetent to alienate property; and they create a costly bureaucracy to manage a national registration system for art. The concept should be abandoned.

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