IS ART SPECULATION PROFITABLE?

The enormous prices paid for paintings at auction today suggest that art is a particularly profitable field for investment. It is undoubtedly possible to reap high returns in the market for paintings—provided one has invested in the "right" pictures. The last owner of van Gogh’s Sunflowers bought it for £24,000 in 1934 and sold it for nearly $40 million in 1986, which means a real rate of return—allowing for inflation, that is—of 11% per year (after deducting the auction fees). Wendell Cherry, the last owner of Yo Picasso, a 1901 postimpressionist self-portrait, did even better. In 1981 he bought the painting at auction for $5.83 million; he sold it at auction in 1989 for $47.85 million, achieving a real net rate of return of 19.6% per year. This is certainly a most satisfactory investment, but even higher profits can be had. The American real-estate investor Gerald Guterman bought a still life by Jan J. den Uyl for roughly $400,000 in 1984, and sold it for $2 million in 1988, thus reaching an annual real net rate of return of 31%. Even more successful was Jacob Duck's Guardwoman Interior. Guterman acquired this painting for $21,170 in 1986, and sold it only two years later for $130,000, yielding a real rate of return (after deducting all costs) of less than 77.4% per year.

But things may also turn out quite differently. It is a mistake to identify the high price rises of an auctioned painting or other antique with a high rate of return. The art market is characterized by particularly stiff transaction fees. Typically, both buyer and seller must pay 10% of the hammer price to the auction house (the rate at Sotheby’s and Christie’s in London and New York, although this is sometimes waived). In many countries these fees are even higher; they can easily amount up to 30% of the auction price. There are, in addition, insurance costs, which amount to something like 0.5% per year of the object’s value. The price of a picture must therefore rise strongly simply to cover these costs. And, obviously, as any investor in financial assets knows (but as art investors frequently forget), inflation must always be taken into account. Merely in order to keep up with the rate of inflation obtaining over the past few years (1970-88), the buyer of Yo Picasso must sell the painting in only five years’ time (1994) for $65 million. If he wants, moreover, to cover the auction fees (assuming them to be 10% for buyer and seller) as well as insurance premiums, the selling price must rise to $81 million. Thus, in only five years, the monetary value of Yo Picasso must appreciate by less than $33 million before the owner can be said to have made a profit.

Indeed, the price increase required to compensate for inflation plus auction and insurance fees is often not reached. Specula-

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By Bruno S. Frey and Angel Serna

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ESSAY

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spent upwards of $50 million on his collection only to see buyers turn up their noses when he put it up for sale in 1938. It was a ghastly time for art prices. A van Dyke portrait went for only £1,995 that year in London, less than a third of what it made twenty years earlier, while a year later, Turner’s Double Rainbow would fetch just £110, less than a tenth of what it got in 1877. Yet the Hearst collection managed to do even worse. Auctions in New York and Chicago were flops. Although Gimbel’s department store agreed to take over disposal of the Hearstian white elephant, sales still totaled just $11 million by 1941. Among the astounding discounts: a Spanish Gisbert monstrosity for which Hearst paid more than $1 million and then had transported to the United States in 1929, yet which wound up going for just $50,000.

Of course, anyone who buys during a boom and sells during a bust is in trouble. But even when times are good, the story of a silver-tongued New York investment advisor named David Bloom shows that collecting is not without its perils. By the time he was just twenty-three, Bloom had sunk $10 million into American paintings, real estate, jewelry, and other accouterments of the luxurious lifestyle he believed he would be commensurate with his new role as a wealthy connoisseur. However, Bloom differed from other collectors in one significant respect: the money he used was not his own, but that of his clients, who had given it to him to invest for them in the stock market. In early 1980, he was charged with defrauding his clients of the money. At the time, the media spin on the story was that, given the stock market crash, Bloom had inadvertently served his clients better by taking their money and investing in art rather than the stocks they thought they were buying. In Bloom’s case, however, he overpaid so egregiously (no small feat in a bull market) that most of his collection—including works by Sargent, Cassatt, and other American impressionists—was wound up being sold for a loss.

Finally, there is the British Rail Pension Fund, proof that even if one invests carefully and soberly under optimal market conditions, art is still not much better than pretty good. Beginning in 1974, the fund’s managers decided that instead of the usual practice of sinking the pension assets under their control into high-grade stocks and bonds, they would divert five or six percent—£40 million in all—into art. Sotheby’s agreed to advise on what to acquire and to supervise the purchases. To spread the risk, it was decided that the money would be evenly distributed across a broad range of fields, everything from Egyptian sculpture and tribal art to old-master prints and impressionist paintings. British Rail represented the biggest corporate plunge into the art market in history, and considering that the objects were not to be put on display but would be locked away in a vault, the purest test of the art-as-investment principle to date.

By 1980, the “collections” were completed, and the world sat back to wait. Seven years later, when the fund began selling off its old-master and Japanese prints and silver, Sotheby’s reported that the value of its assets had gone up about three and a half times. Amid all the crowing, though, it soon turned out that, based on the stock index, the money would have gone up 4.1 times had it been invested in the equity market. When dividends were taken into account, things looked even worse. Stocks pay dividends, but paintings don’t (not even aesthetic dividends in the case of works hidden away in vaults). Whipping out their cal-

Bruno S. Frey is professor of economics at the University of Zurich’s Institute for Empirical Economic Research. Angel Serna is assistant professor.