

A Market under Threat

*How the European Union could destroy
the British Art Market.*

DAVID HEATHCOAT-AMORY MP





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CHAPTER 1

INTRODUCTION

A LARGE AND IMPORTANT BRITISH INDUSTRY is under threat; not from competitive pressures, but from a hostile tax regime imposed by the European Union.

London is the centre of a remarkable international art market. By value of auction sales London is second only to New York. By other definitions it is the world's premier art centre and certainly by far the largest in Europe. Success in this highly mobile business depends on attracting buyers and sellers from all over the world. Customers come for the auction sales in London and for the network of galleries, dealers, valuers, restorers and experts throughout the United Kingdom. Collectively these businesses employ over 50,000 people. In European terms the British art sector is unique.

This market is now at risk from two clumsy and damaging proposals put forward in the name of European harmonisation. The first would impose a 5% rate of VAT on works of art imported from outside the EU and is due to take effect in July 1999. The second would impose a levy of between 2% and 4%, called *droit de suite*, on the re-sale of 20th century works of art. If enacted this levy will drive such sales out of London to other art centres like New York or Geneva which have no intention of applying such a levy.

Either of these two taxes will have a severe effect on the attractiveness of Britain as an international art centre. Together they would destroy it.

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The issue illustrates with stark clarity how the European Commission's obsession with harmonisation drives businesses away and makes the European Union uncompetitive in world markets. If the British art market is forced to adopt the higher tax rates and resale levy prevailing in some other member states the result will be a loss of art, revenue and jobs to non-EU countries. Instead of promoting and helping a European success story, the EU will have destroyed it. This is a poor return for the £7 million a day net contribution which the UK pays into the EU budget.

The drive to harmonise regulations and taxes across the EU came initially from the Single Market project. It is now being given impetus by the arrival of the single European currency. EMU (Economic and Monetary Union) is not only about launching a Monetary Union; it is also about creating an Economic Union going far beyond the Single Market. This has received less attention than the monetary aspect but it is being pursued in parallel. Economic union requires a high degree of tax harmonisation and does not respect the 'opt-outs' which some countries have from Monetary Union.

Tax harmonisation in the EU is invariably upwards. This conflicts with the need to maintain and promote EU competitiveness in the global marketplace. The EU is already a zone of high and persistent unemployment: it cannot afford to lose international businesses because of unnecessary tax or regulatory burdens.

The story of art taxation and the threat to the British art market is not just important in itself. It demonstrates the more general failure of the EU to come to terms with its place in the world and to jettison some of its failed economic nostrums.

The tax proposals for art are at an advanced stage. They can be halted only if the British Government puts up determined opposition and insists that the EU puts its wider economic interests ahead of its domestic agenda for a European state.

CHAPTER 2

THE BRITISH ART MARKET

THE TOTAL BRITISH ART MARKET is comprised of about 10,000 businesses with an annual turnover of just over £2.2 billion.¹ The Bond Street and St James' area of London contains the world's greatest concentration of auctioneers and dealers. Outside London is a huge network of similar but smaller businesses. Then there are the support services, such as conservation, restoration, the organisation of fairs and exhibitions, and shipping, insurance and freight. When all these ancillary businesses are taken into account, the economic impact of the British art and antiques market is larger than the music business and comparable to the book industry. Total employment is estimated at just under 51,000.

For many years the British art market fed largely off domestically generated business, such as country house sales. Much less business is now available from these sources and the consequence has been a growing dependence on trade from abroad. The big auction houses rely on works of art being sent to London for sale. This attracts foreign customers who not only buy at auction but are also vital to the trade through specialist dealers. Businesses outside London also frequently sell works originally sent from abroad, or are dependent on foreign buyers at some point in the chain.

¹ The figures in this section are taken from the MTI report, *The British Art Market* (1997), prepared for the British Art Market Federation.

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The large number of foreign visitors coming to Britain to buy and sell art is itself a source of foreign exchange earnings. For 1995 this is estimated at some £2.8 billion. As well as being spent directly on art and antiques, it benefits hotels, restaurants, shops, taxis and the tourist trade generally.

The prominent position of London in the art trade illustrates a truth about the United Kingdom's place in the world, and the unusual position that it holds in the European Union.

Throughout our history two forces exert their influence upon us: the Continental and the Atlantic. On the one hand Continental Europe has always exerted a pull natural to its proximity. Our membership of the EU and the Single Market reinforces it. On the other hand Britain is also a global trader. This 'Atlantic' side to our national character explains the extraordinary spread of the English language, the huge size of our overseas investments,² and the fact that over half of our total foreign earnings still come from countries outside the EU.³

This dual nature explains how Britain has built up very strong positions in a number of financial and trading sectors. The international art market is one of them, rather similar to the position of the City of London in the financial sector.

But it is vulnerable. Art is a totally mobile commodity. A picture can be just as easily sold in Geneva, Tokyo or New York as in London. Competition in this global marketplace is fierce and unrelenting. The decision where to sell is highly sensitive to comparative costs. If one art centre faces the imposition of an additional tax or regulatory levy, business simply moves away to the others.

² Direct and portfolio assets totalled £731.7 billion in 1996 – more than any other G7 country (Source: *Pink Book* 1997).

³ 51.1% of current account credits were from non-EU countries in 1996 (*ibid.*).

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The British art market faces exactly this threat. It comes from two taxes proposed and promoted by the European Union. Like a nutcracker these taxes hold the British art market between them. If the nutcracker closes it will do irreparable harm to an important British industry, and prove beyond doubt that the internal politics of the EU count for more than the economic wellbeing of a member state or European success in the wider world.

CHAPTER 3

THREAT ONE: VAT ON IMPORTS

UNTIL 1995, THE IMPORTATION INTO THE UK of works of art, antiques and certain collectors' items was free of VAT. The exception was works of art created after 1973 which were (and still are) liable to full VAT when imported.

The freedom to import the great majority of art objects without liability to VAT was crucial in enabling London to become a major centre for the world art market. It also encouraged the repatriation of our cultural heritage. It did not of course mean that the market was exempt from VAT as a whole: VAT was payable, as now, on the dealer's profit margin and the auctioneer's commission. This combination of taxing the profit on internal transactions while exempting imports meant that the Treasury gained revenue from the expanding UK market.

This desirable state of affairs ended when the Seventh VAT Directive was agreed in 1994. This sought to harmonise the levels of import VAT throughout the EU and fixed a minimum rate of 5%. The British art market lobbied vigorously against it and the Treasury minister responsible, Sir John Cope, managed to obtain a special rate for the UK of 2½%. This would apply until June 1999 when the 5% minimum would become mandatory for all unless superseded by another agreement. He also secured an undertaking from the European Commission that it would carry out a study of the effects of VAT on art imports by the end of 1998.

THREAT ONE: VAT ON IMPORTS

The UK art trade has repeatedly warned that the imposition of import VAT, even at a low level, would deter works of art from being sent for sale in London from outside the EU. This has happened. Imports of fine art from non-EU countries fell heavily in 1996. Despite some recovery in 1997, imports of fine art and antiques are 22% lower than the pre-VAT level.⁴

It is not just the direct cost which puts off foreign business. It is also the paperwork. If a work of art is brought into the UK, bought by someone from a non-EU country and then re-exported, the 2½% VAT is not charged. But this exemption is not straightforward. The work will be held as a Temporary Importation, under which the VAT is not actually paid but security has to be lodged in the form of a bond or bank guarantee. This involves numerous cumbersome administrative procedures and checks which are expensive for both the trade and Customs & Excise.

There are many anecdotal examples of trade being lost from London because of import VAT. Johnny van Haefen, a London specialist in Dutch pictures, reports the case of a Swiss client who wished to sell 23 Flemish pictures worth about \$3 million. The sale was eventually switched to New York because of the complications, delays and expense of import VAT in the UK.

In March 1997 the leading Oriental art dealer, Eskenazi, held an exhibition in New York, the first away from its London gallery. According to Giuseppe Eskenazi: "It was perhaps an overdue step, but one that was promoted by the fact that London is losing its status as the art capital of the world, as a direct result of the EC regulations on antiques. Switzerland and the US in particular will benefit as it will no longer make sense to import antiques into this country."

⁴ H M Customs & Excise figures, March 1998.

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Against this background, the proposed doubling of VAT on imports would be wholly destructive. Although promoted by the European Commission as a harmonising measure it is impossible to see the justification. There is no evidence that the business deflected from London by the 2½% import charge has gone to other EU countries: it has been lost to the EU completely. Even as a harmonising measure it has not succeeded. If Britain is forced to impose the 5% minimum, the rates in other EU countries will still range up to 25%, (the rate in Denmark).

Another justification behind this mistaken policy might be the orthodoxy that a sales tax should be applied to all imports in order to ensure equal treatment between domestic and imported goods. This ignores the clear distinction between cultural goods and consumer goods. VAT is levied on the import of consumer goods to equalise the tax treatment between an item manufactured outside the EU and an equivalent one made within the EU. This ensures that industry at home is not put at a disadvantage from imports. But works of art and antiques are different: importing them does not threaten European jobs; indeed it creates jobs by strengthening the art market and providing work for the associated businesses of restoration, valuation, insurance and so forth.

The fundamental error in this whole harmonisation drive is a failure to see Europe in a global context. The mobility of art and the sensitivity of buyers and sellers to comparative costs mean that the EU must fight hard to retain its competitiveness. London, and the British art market generally, has been successful in this. It should receive every help and encouragement from the institutions of the EU. Instead there is a determined campaign to double the rate of VAT on its art imports, which will cut off its lifeblood.

As well as these commercial considerations, there is also a purely cultural advantage in allowing art to enter a country free

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of tax. Periodic wars and upheavals in Europe led to large scale exports of works of art, particularly to America. Most European countries now have strict rules regulating or preventing the export of particularly important objects. It is contradictory to do this while discouraging the return of such works by imposing a tax on their importation.

So far these appeals and arguments have met with no response. The European Commission is bound by the 1994 agreement to conduct a study into VAT on art imports, and this is due to report by the end of 1998. The Commission has indicated that it has little sympathy with the British case, which it sees as conflicting with the drive to establish a more uniform tax system throughout the EU. It is essential that the British art market and the British Government co-ordinate a timely, detailed and vigorous case for at least allowing the present tax regime to continue.

Meanwhile the energy of the European Commission has been concentrated on designing the other half of the nutcracker.

CHAPTER 4

THREAT TWO: *DROIT DE SUITE* HARMONISATION

DROIT DE SUITE (ARTISTS RESALE RIGHT) is the levy imposed in several EU member states on the re-sale of modern works of art. Under it, a percentage of the re-sale price is paid by the vendor to the artist or his heirs for up to 70 years after the artist's death. The intention is to put artists on an equal footing with writers and composers who may continue to earn royalties on their work throughout the term of copyright.

France in 1920 was the first country to introduce this *droit de suite* levy. This was in response to claims that struggling artists were failing to benefit from subsequent increases in the value of their work. Today nine of the fifteen member states in the EU apply a *droit de suite*. The rates vary between 3% and 5% of the sale price and it is usually levied on works of fine art and sculpture which are sold by public auction or through a dealer.

Droit de suite suffers from a number of theoretical and practical weaknesses. In consequence Italy and Luxembourg have not brought it into effect although they have passed the necessary legislation. Four other member states (Austria, Holland, the UK and Ireland) have no *droit de suite* at all. Neither have the United States, Switzerland or the countries of the Far East.

The European Commission has brought forward a Draft Directive to harmonise throughout the EU the various provisions for artists' resale rights. The Commission argues that present disparities, and the absence of any such rights in some countries, are a distortion of the single market. They propose that on the

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resale of any 'original work of art' above £800 in value, the vendor shall pay a levy of 2% – 4% depending on the price. This would go via a collecting agency to the artist, or his heirs for 70 years after his death, every time the work of art is sold. The Commission claims this is a trade issue and not a matter of finance or taxation, so the Directive can be passed by majority voting.

What this fails to take account of is that art is traded globally, and the world is a great deal larger than Europe. Valuable works of 20th Century art will not be sold in London, or other EU centres at all, if sellers face this *droit de suite* levy. Instead the sales will go to New York, Geneva, Tokyo or any other art centre where the levy does not apply.

This is confirmed by the European Commission's own logic. It asserts that lower sale costs give London an advantage over the other EU countries which currently enforce a re-sale levy. Exactly the same advantage will be enjoyed by New York and the other world centres if London is forced to charge a *droit de suite* levy.

London has by far the largest art market in the EU with a correspondingly large number of items sold on which the levy would be paid. The resale right would apply to original manuscripts, paintings, drawings, prints, sculpture, tapestries, ceramics and photographs. Because *droit de suite* applies for 70 years after the death of an artist, the levy is applied to the work of all those who have died since 1928. For example, all the works of Matisse who started painting more than a hundred years ago, would be included. So would any work by Picasso: his heirs would benefit from *droit de suite* until the year 2043.

It is estimated that the levy would apply to about £373 million of sales revenue each year in the UK.⁵ Over half the London business comes from outside the EU and this is easily deterred

⁵ MTI Report, op. cit., 1997.

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by higher charges. For example, under the Commission's proposals, a foreign owner of a Picasso worth \$1 million would pay *droit de suite* of \$22,420 if he sold in London. No such levy would be payable in New York so it is not hard to guess where the owner would send the picture for sale.

Art from within the EU would also be sent abroad. A British seller of an Epstein bronze, for instance, would have every incentive to send it out of the EU altogether to escape the levy. The cost of sending a work of art to New York would be more than offset by not having to pay *droit de suite* for works of art valued above about £15,000.

The Department of Trade and Industry have carried out an assessment of the likely damage to the British art market. This indicates a loss of revenue of up to £68 million per year, with up to 5000 job losses, together with a reduction in VAT receipts as business goes abroad.⁶ The European Commission disputes these figures but has not done an analysis of its own or produced any alternative figures.

The Chairman of the British Art Market Federation, Anthony Browne, wrote to the Commission Directorate with the evidence of potential damage. In reply the Director-General wrote, "It appears to us that the arguments you put forward reflect to a large extent the views of certain multinational auction houses that are members of your organisation". This remark illustrates the Commission's approach: its mission to standardise taxation and regulations across the EU takes precedence over the real life experience of those trading in the wider world.

Nor is it in fact true that Christie's and Sotheby's would be the main losers if the Commission's VAT and *droit de suite* proposals become law. Each company has substantial American interests and could transfer more of their auctions to New York or other

⁶ *Initial Compliance Cost Assessment*, DTI, June 1996.

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centres where they already operate. Instead the losers would be the businesses which cannot easily move, the associated network of dealers, valuers, restorers, printers, framers, shippers and insurers. It would not be the owners of the 'multinational auction houses' who would suffer by a move to New York, but the British-based experts, office staff, porters and packers.

A country wishing to introduce a compulsory *droit de suite* will naturally weigh up the supposed benefit to its artists against the possible damage to its international art market, if it has one. Thus when Germany introduced a 5% resale levy in 1965 it will have done so in the knowledge that it would deter some sales from taking place in Germany. That is an entirely legitimate decision for a national government to take. In Germany's case it was no doubt influenced by the fact that no significant international art market is based there.

The European Commission now proposes that *droit de suite* should be imposed on EU countries which have taken the opposite view, that the loss of business and disruption of trade outweigh any likely benefit to living artists.

This is the worst form of harmonisation in the EU – a levelling up of taxes and costs regardless of the wider consequences. The European Parliament examined the proposals and agreed that the Directive should proceed subject to a few amendments. British MEPs took little interest in the subject and generally failed to register the strong objections relayed to them by the British art market. Three MEPs voted against the proposals in the relevant Parliamentary Committee but none of these was British.

The difficulties with *droit de suite* were recognised in this country by the Whitford Committee which reported to Parliament on copyright law in 1977.⁷ It noted that private sales

⁷ *Report of the Committee to consider the Law on Copyright and Design*, Cmnd 6732, Ch 17.

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of art could not realistically be monitored or made subject to the levy and therefore transactions would be driven away from auction houses and dealers. Apart from the commercial damage, artists would of course receive nothing at all if transactions were driven underground in this way.

The Whitford Committee noted the high costs of collecting the levy, particularly where small sums were being chased up from modest sales. Collection costs in Denmark are estimated to be 40% of the levy raised.⁸

The Committee also observed that it would be unfair to extract a re-sale levy in cases where the sale was being made at a loss after allowing for inflation. Any provision to tax profits only would further complicate the calculation of *droit de suite*.

The Whitford Report therefore came down firmly against *droit de suite* for the UK. A similar report in the United States reached the same conclusion.⁹ The art market in America can hardly believe its luck that the European Union is planning to drive out a significant part of its own most successful art business.

Many of the people who might expect to benefit from the introduction of *droit de suite*, the artists themselves, are far from enthusiastic. British artists want to see this country remain a strong centre in which their works are sold and resold publicly. If secondary sales of their work are transferred abroad, or driven underground to avoid the levy, all this will be damaged, and neither would they receive any levy money.

The introduction of *droit de suite* is also likely to depress the price at which a work of art is *initially* bought from the artist. This is because a buyer will take into account the future cost of paying the *droit de suite* levy if he sells it on. This compensation for future costs will be factored into the original price, making it

⁸ *The Droit de Suite*, IFO Institute for Economic Research, Munich, 1995.

⁹ *The Artist's Resale Royalty*, a report by the Registrar of Copyrights, December 1992.

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lower. If the work is resold at some stage, the artist may recoup the initial price fall from levy proceeds. But if the work is not resold, or if the sale takes place outside the EU or is driven underground, then the artist will end up actually worse off.¹⁰

If *droit de suite* benefits anyone, it is the heirs of successful dead artists like Picasso. It is estimated that three-quarters of the levy collected in France benefits just six families. Living artists who become well known are, in any case, able to sell their future work at high prices. If an artist is not successful there will be little or no secondary market from which to claim *droit de suite*. After enforcement and collection costs have been deducted the majority of artists receive little or nothing. Meanwhile the primary market (on which most artists rely) is damaged, sales are disguised or transferred abroad, and relations between dealers and artists suffer. A recent study of the practical application of *droit de suite* says, 'it is difficult to avoid the conclusion that the *droit de suite* would make things worse for most artists.'¹¹

In any case artists can impose a resale right through private contract if they believe it is in their interests to do so. There is a substantial market for licensed reproductions and artists do create editions of cast sculptures and fine prints. Thus if artists wish to retain an interest in the exploitation of their work, a private solution already exists.

Droit de suite is therefore a faulty economic instrument, difficult and expensive to enforce, of little or no benefit to artists, and damaging to art markets where it is imposed.

The European Commission has refused to undertake a study into the economic consequences of *droit de suite*. It is also

¹⁰ V Ginsburgh, *On the economic consequences of resale rights on art*, Université Libre de Bruxelles, 1996

¹¹ J H Merryman, *Opinion on the Proposed Generalisation of the Droit de Suite in the European Communities*, Intellectual Property Institute, 1996.

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adamant that this is a trade rather than a fiscal matter, and therefore falls to be decided by majority voting in the Council of Ministers. Any legal challenge to this can only be mounted *after* the Directive comes into effect.

The British Government is aware of the threat to the British art market and those who work in it. Lord Haskel, Government spokesman in the House of Lords, said, "This Government, like the last one, is opposed to the introduction of artists' resale right."¹²

The Directive can be defeated by a "blocking minority" of at least 26 votes in the Council of Ministers. The UK has 10 votes. Holland, a reliable ally on this issue, has 5 votes. Ireland with 3 votes, does not at present have *droit de suite* and might therefore resist its introduction. The support of another large country is required, and Italy (with 10 votes) is reported to be unhappy with the European Commission's insistence that *droit de suite* should be payable even when a vendor makes a loss on a sale.

With energetic lobbying at a high political level it might be possible to assemble the necessary blocking minority. Otherwise the impetus created by a determined European Commission, a compliant European Parliament, and a majority of member states which already have *droit de suite*, will push this Directive through regardless of the damage it will cause to British art market.

¹² House of Lords Official Report, 10 December 1997, col. 223.

CHAPTER 5

CONCLUSION

THE MAIN QUESTION FACING the European Union is whether it can adjust to the realities of global competition or whether it continues to give priority to an internal agenda of standardisation, regulation and high taxation. 18 million people unemployed in the EU is a good reason for tackling this as a matter of urgency.

Instead, tax harmonisation is being pursued with increasing vigour by the European Commission. Company taxation is now subject to an EU Code of Conduct designed to prevent 'unfair tax competition', – that is, low taxation. The Commission also has an ambitious programme to standardise the administration of VAT and the rates of tax charged. These plans go far beyond any requirement for the Single Market and are now seen as necessary for the success of the single European currency. Since tax harmonisation inevitably means tax increases, this strikes at those sectors which rely on attracting global business. The British art market is an example.

The European Treaty does require measures for 'the strengthening of the competitiveness of Community industry'.¹³ It might therefore be hoped that an international success such as the British art market would receive active help and encouragement. Instead, the two measures discussed in this pamphlet will gravely damage it, and the beneficiaries will overwhelmingly not be other member states but countries outside the EU.

¹³ Treaty on European Union, Article 3(m).

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When Tony Blair addressed the French National Assembly in March 1998 he reaffirmed the importance of distinguishing between matters which are best decided at EU level and those which are best left to national governments. He included in the latter category taxation and cultural matters. The Prime Minister should therefore follow up his words with equivalent deeds, by taking up the cause of the British art market.

The Government talks a lot about 'Cool Britannia'. It wants to modernise the image of Britain abroad. The international art market is an important part of what makes London a vibrant and successful world city. If Cool Britannia is to be anything more than a political slogan, the Prime Minister must defend an industry in which Britain is a world leader.

In the case of the threat to double VAT on art imports, the British Government should at least demand and secure an extension of the permitted 2½% rate for the UK. Better, the threat should be lifted permanently by reducing the permitted minimum to 2½% for all EU countries. This requires the unanimous agreement of other member states. This is achievable since what they are being asked to agree is not a new imposition or financial obligation, but rather the continuation of a low-tax regime to allow the EU to compete in the wider world and stop the loss of business to non-EU countries.

The *Droit de Suite* Directive requires a similarly high level intervention. If the European Commission cannot be made to see how impractical and damaging their proposals are, the Prime Minister must raise it directly with other member states and get the Directive withdrawn.

Britain holds the presidency of the EU. This is a good opportunity to grasp these issues and give substance to an alternative vision of the European Union – outward looking, competitive and free. Failure would mean the sacrifice of a British success story on the altar of a European state.