THE ART NEWSPAPER, No. 141, NOVEMBER 2003

Auction house settlement

Winning twice?

Economists say the payments are unfair

Not an eyebrow has been raised about the share-out of the payments made as part of the settlement in the Sotheby's and Christie's auction house collusion affair. Under its terms, successful sellers receive about one percent of the sales price, while successful buyers receive five percent of the sales price. It is uncontroversial that commission fixing is wrong, and that losers should be compensated. After all, if because of commission fixing the price paid by buyers increases by five percent, shouldn't buyers be compensated for this? And if sellers pay only one percent more on the object sold, should not they receive significantly less than buyers? This would seem to be good and simple economics. Simple but, unfortunately wrong.

At auction, bidders take into account the relevant economic variables in their bidding decision. These include the number of participants, the value of the object to the bidders and the commission rates, known to both sellers and buyers. If the commission rate increases, the actual bid (before commission) will decrease by the same factor in order to keep the effective price paid by the buyer equal. Thus, changes in commission rates do not change the price paid by the buyer: they just affect the hammer price. There is no logical reason in this situation to compensate buyers. Sellers, however, may lose since they receive a lower price for their object when commissions rise.

But this is not the whole story. Commissions have an impact on buyers' and sellers' participation. Sellers who are worse off because of the commission may decide not to auction their objects or to increase reserves. Fewer objects to be auctioned lead to more competition between buyers, and thus to higher prices. This in turn can dissuade potential buyers to participate in the auction. The resulting welfare analysis therefore depends on how elastic the participation decisions of buyers and sellers are. In fact, successful buyers can end up better off despite higher commissions. If sellers respond to the increase in commissions by setting higher reserves rather than withdrawing from the auction, the auction becomes less attractive to buyers. This means that the buyers who participate in a purchase may face less competition and end up paying a lower price to win the auction. The method used to share the settlement in the class action seems inappropriate. It gives the short end of the stick to the sellers who clearly have not been compensated properly. Actual buyers receive most of the money while it is debatable whether they should receive any. Another welfare loss comes from transactions that have not taken place due to higher commissions, but it is clearly not easy to compensate the "would-have-been" buyers and sellers.

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