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MONEY FOR OLD SOAP

Welcome to the art market, where people fight to buy houses that don't exists, bars of soap sell for £25,000, and a photograph of training shoes sells for £400,000. Marc Spiegler meets the brokers who decide what you'll pay for a Damien Hirst or a Jeff Koons and reveals the unwritten rules that govern every sale

Take a few dozen pieces of different-coloured soap, rounded by use to an ovular smoothness. Drill a hole through the smallest central axis. Now, thread a metal cable through the holes. Attach the cable to the floor and then to the ceiling. The result: a 12ft tower of soap, looking like a giant necklace of sweets.

Technically speaking, any half-handy person could construct this on a free Sunday. Since the creator, however, is the Polish artist Miroslaw Balka – a well-respected purveyor of conceptual installations – the structure stands not in some suburban garage but in the White Cube gallery booth during Art Basel in Switzerland. This fair, held in June every year, is the world's prime contemporary-art marketplace. The competition between big collectors there annually turns so ardent that multimillionaires commonly pose as gallery staffers to sneak on to the floor before the fair opens to buy works barely out of their crates. So while you could build a Balka simulacrum for the price of a used bike, 370 Centimeters of Soap costs £25,000.

On the other side of the fair's floor, a digital animation called Sprawlville, available as a DVD, thunders out a techno beat. The camera swoops through an American hell of suburban malls and prefab houses. The 10-minute video by Sweden's Sven Pahlsson is visually entrancing but also disturbing for its pervasive sense of anomie. Sprawlville is significant for belonging to the first wave of digital art worthy of being called art; fittingly, the animation sold out in the first day of the fair, at $10,000 (£6,450) per private buyer; six museums are vying for the three $35,000 (£22,550) public-display versions.

On a wall beside Sprawlville a trio of small monitors show homes exactly like those in the video. They belong to an ancillary set of works centred around three digital subdivisions. Buying one gets you an animation of "your" house, plus a map of the "neighbourhood". The basic model is $2,800 (£1,800), but paying extra gets you a bigger house, a barbecue grill, a car, a boat and other accessories – all just bits and bytes, of course. By the time the fair ends, Sprawlville "estate agent" Brownstone Corp (ie Pahlsson's gallerist, Spencer Brownstone) will sell more than £100,000 worth of its virtual property.

All of the above might seem completely absurd to some readers. Although really, the art market's no more absurd than that of any other luxury good. When you buy Prada, it's the red stripe you're paying for, not superior protection from the elements. Likewise, entirely rational people pay quintuple the Oddbins price for a bottle of Shiraz in a restaurant. And really, can anyone justify flying business class, unless someone else is paying?

Granted, the occasional gallery visitor may be shocked when scanning the price-list at an opening. Yet while the pricing of art might seem inherently abstract, it is not illogical. "We recalibrate the prices every time we show an artist, and the process is like walking a tightrope," says New York gallerist Sean

Kelly, who worked in London before decamping to New York. "You sniff the wind, you adjust the balancing pole, you adjust your body, you feel the rope – and you move ahead. No hard-and-fast formula exists."

Artists tend to be heavily involved. At the most extreme, critics charge, art stars such as Damien Hirst and Jeff Koons have become the Madonnas of the cultural world, displaying a real genius not in their work but in the manipulation of their market. (One cannot imagine any current artist signing a five-year agreement to sell their work piecemeal at rates fixed by their size, though that was the arrangement between the Marlborough gallery and Francis Bacon, the greatest English painter of the 20th century.)

There may be no perfect equation for contemporary-art valuation but the range of factors involved is pretty constant. Though opaque to those outside the art world, they are hardly complex. Exceptions exist, but the following six rules can explain the price of almost every work sold today.

Rule 1 Material Costs Matter

File this under "D", for "dead obvious": the higher a piece's production cost, the higher its price. "For us to make money, the costs involved can never be more than 25 per cent of the piece's price," says Berlin gallerist Matthias Arndt, whose brainy artist roster includes Sophie Calle and Thomas Hirschhorn. "The price for our younger artists' work is around $5,000 (£3,200), so we lose money on every sale. We only start really making profits when pieces rise over $20,000 (£13,000) or $25,000 (£16,000)."

For emerging artists, often living at near-subsistence levels, materials and other expenses involved in production are critical factors, since they generally pay such costs from their half of the work's sale price. "When we set prices for our younger artists, we're calculating based on materials and labour," says Jenny Liu, co-director of The Project, a New York gallery reputed for its avant-garde offerings. "Frankly, we're just trying to make sure they can do their art full-time and quit waitressing." The first price rise commonly comes when works start really selling. That's not just spurred by gallerist greed, says Liu's partner, Christian Haye: "As soon as someone gets a little famous, they need more production space and an assistant to stay sane."

Traditionally, as an artist's market matured, prices were not so driven by production outlays and profit margins rose. This may be changing, however, since lately it's not just egos but also budgets that are swelling with success. When Turner Prize-winning sculptor Rachel Whiteread left her dealer Karsten Schubert to join Anthony D'Offay in 1997, one major attraction reportedly was D'Offay's offer to cover her costs. Hirst's last show, at the Gagosian Gallery in New York, reportedly cost more than $1m to produce, and American stars like Koons have burned mountains of gallerist money with diva-like demands.

Even if such costly work sells out, that's not always enough to pay off such mammoth artistic enterprises. Thus, gallerists have developed a slew of ancillary products akin to Brownstone LLC's digital subdivision. The most extensive case involves US artist Matthew Barney (aka Mr Björk). His five Cremaster films – a witch's brew of Art Deco imagery, Celtic lore and other mystical milieus directed by, and starring, Barney himself – have been multimillion-dollar projects. The most recent had a budget of more than $4m; to make its costs back, Barbara Gladstone gallery has sold stills from the footage, props used in the shoots, and even the storyboards plotting camera angles.

Rule 2 You're Not Really Buying Objects

Last summer, I was writing about Nic Hess, a fast-rising Swiss artist. He specialises in using small strips of adhesive tape to make wall installations combining icons as disparate as geisha girls, Puma logos and Pinocchio. Working much like a DJ, he collects images and then mixes them on the spot. "It's something I do by feeling and I rip down 40 per cent of what I first put up," Hess said. "I'm not really an intellectual artist." Yet when I called one of his gallerists about the work – which costs $25,000 (£16,000) per large wall – the dealer gave me 15 minutes of art theory, obscure references and psychobabble.

Such mumbo-jumbo is key to selling art. While some collectors buy art for purely aesthetic or intellectual reasons, much of the business is founded upon a sort of transubstantiation: convincing rich people that buying a work will make them cooler and smarter – no longer a mere lawyer, banker or adman, but rather a modern-day Medici. The ritual of studio visits and dinner parties with artists rounds out that recasting.

What's really being sold, then, is not an object but rather the right to claim ownership of a small land parcel in the kingdom of art history. The value of that parcel goes up due to favourable reviews, solo shows and buying by important personages. It can also go down, just as a nightclub space will sink in value when a neighbourhood becomes less trendy. And if a painting suddenly proves to be fake, its worth plummets just as quickly as that of a house discovered to sit atop a toxic-waste dump. Yet, through all this, the work itself is unchanged – its beauty just as capable of producing rapture, its content just as apt a subject for reflection.

The ectomorphic sculptures of the late Alberto Giacommeti nicely illustrate this disjuncture between physical object and market value. Once Giacometti finished producing the original plaster version of a work, his brother Diego commonly oversaw its actual production as bronzes. Today, pieces cast before Alberto's 1966 death are worth the most, starting at $500,000 and selling at auction for up to $17m. Those pieces whose posthumous production was overseen by Diego are worth significantly less. Least valuable of all are the works cast after Diego's death and authorised in a slightly larger edition size (eight instead of six) by Alberto's widow, Annette. They never go much over $800,000 (£515,000), despite the fact that Alberto Giacometti was no less involved in forming the figure itself.

Rule 3 Only Little People Pay Retail

Among contemporary-art buyers, many never pay the neatly-typed number on the show's price list; reductions are the *monnaie courant* of the art trade. "We always discount the work of younger artists, because we're trying to build a market for them," explains Glenn Scott Wright, director at London's Victoria Miro gallery. "But you don't do it as much when an artist's market is fully formed."

Regardless of how established an artist becomes, however, most galleries give huge markdowns (20 per cent is common) to museums and other cultural institutions. While many dealers fit the trade's venal-opportunist stereotype, even the most venal live by the injunction of Goldman Sachs legend Gus Levy: be "greedy, but long-term greedy". Scan any artist's biography and inevitably the last section details all the collections to which their work belongs. A heavy sprinkling of international institutions functions as a form of instant vetting – and more importantly as a stable reference for the artist, since few museums ever sell off work. Even when bad reviews wallop the artist or pieces go unsold, those permanent-collection coups serve as bona fides of historical significance.

On those same CVs you'll always find the names of a few heavy-hitting collectors, the sort whose buying offers an imprimatur. They too get reduced prices, for some of the same reputation-building reasons as museums. Naturally, just as some people expect inclusion on every club's VIP list, quite a few collectors have an inflated sense of their standing. "Some collectors come to my stand and demand a 25 per cent discount based purely on their 'reputation', without having ever bought from me," says Arndt, seething. "I usually throw them out of the booth. Sometimes they say, 'Call me when it doesn't sell.' I tell them, 'Don't give me your number.'"

Giving collectors big discounts is risky. Unlike museums, collectors sell work off, so their imprimatur can turn into a black mark overnight. In a particularly infamous 1990s example, Charles Saatchi off-loaded his entire collection of works by Sandro Chia, an Italian painter turned Manhattan art star. Chia's market collapsed; the artist reportedly considered "emigrating to Alaska". Today, following the Chia principle, smart gallerists never allow any single collector to gain a controlling share of an artist's oeuvre.

Rule 4 Galleries Thrive On Scarcity

When an artist is truly hot, a multimillionaire could walk in with a suitcase full of cash on the first minute of the opening, adore all the work and still go away empty-handed. The nice term for this is "placement", meaning that the dealer is building the artist's reputation by only allowing major collectors and institutions to buy their work. Cynics call it blatant snobbism.

Long waiting-lists of eager buyers are established for future works by current stars, meaning shows are essentially sold before even being hung. Since these lists are kept secret, there's no telling when you might be allowed to finally buy. Until recently, snubbed collectors had little choice but to acquire "emerging" (not so hot) artists from the gallery in hope of currying favour. But, starting in 1998, auction houses aggressively entered the terrain of contemporary art (see box, right). Their target market: the spurned collector. "When we're trying to figure out if an artist is ready for the auction market, we talk to their potential buyers," explains Cheyenne Westphal, head of the Sotheby's London contemporary department. "If the artist's last show was sold out and 80 per cent of the work went to institutions, that means there were a lot of frustrated collectors."

Such pent-up demand creates disproportional prices. Consider the case of Neo Rauch, the 42-year-old Leipzig painter whose post-Socialist-Realist style caught fire in the past few years. Rauch releases only a score of works every year, so they are scarce. His market skyrocketed due to championing by New York Times critic Roberta Smith and his waiting list grew so long that he declared a moratorium on new additions. Not surprisingly, when his 1998 piece Produktion was auctioned by Phillips de Pury & Luxembourg in May, over a dozen bidders battled. It sold for $134,500 (£86,700), more than double the gallery price.

Rule 4.5 Uniqueness Is Overrated

The most astounding recent art-market development has been the surging market for work produced in editions, especially photography. Historically, serious collectors shied away from multiples; there was always the risk that others owning a copy would try to sell a piece simultaneously, torpedoing its value. Clearly, that prejudice has evaporated: Andreas Gursky's Untitled V – a trainer-shop photo produced in an edition of six – shattered the record for contemporary photography by fetching £432,750 at Christie's London in February. Untitled V's consignment by German property mogul Hans Grothe, had been labelled "reprehensible" by Gursky because Grothe bought museum-quality works at huge discount and had supposedly agreed never to sell them.

As a rule, although scarcity drives the primary market (where works are first sold), volume drives the secondary market (everything afterward). "Strong and frequent auction sales produce the illusion of liquidity," explains Josh Baer, a New York private dealer whose Baerfaxt newsletter tracks the art trade assiduously. "They make people feel safer about buying." Of course, there is such a thing as too much volume. Two years ago, the overheated auction market for Andy Warhol seemed to have flushed out every Warhol print worldwide; more than two dozen Art Basel stands featured his pieces, sometimes piled haphazardly on shelves. Casual visitors developed déjà vu, critics mocked the mediocrities and many pieces went unsold. Presented with so many choices, Warhol's collectors had performed triage, fighting for the top works and ignoring the others.

Rule 5 Auctions Are A Fickle Mistress

One might imagine that record auction results for their artists make gallerists jump for joy. It's often quite the opposite. Gallerists dislike the idea that works pass to the highest bidder, often someone outside their sphere of influence. And while an auction price can simply reflect two men's momentary madness, the ramifications can affect the artist's market for years. "I try to ignore the auctions but they have a visible effect," says The Project's Christian Haye. "Collectors start looking at their pieces and going, 'Wow, I need to cash in.'" Indeed, a single strong "hammer price" can trigger a flurry of collector selling, undercutting the gallery's sales of new work. Even when the collectors offer the work back to the gallery, the auction-based "fair market" price is hyper-inflated

Certainly, auctions also offer some upsides for galleries. Every time an artist reaches a new auction record, more people want to buy their work. "This is the only market where higher prices raise demand and lower prices drop demand," Baer points out. Plus, the work in the gallery suddenly seems an amazing bargain. "People at fairs come and ask me for a 20 per cent discount on Neo's work," says Gerd Harry Lybke of Berlin's Eigen Art, Rauch's primary dealer. "I tell them they're already getting 50 per cent off the auction price." He's only half-joking.

What's worse for dealers than works selling too high at auction? Going unsold. The reasons can vary. Sometimes the auction house has been too optimistic with its estimate and scared off buyers. Sometimes the work isn't suited for auction – intellectual or "quiet" work notoriously tends to fail on the block. Sometimes the markets crashed overnight or the artist's top collector was just hit with divorce papers.

Whatever the reason, work going unsold casts a pall over the artist's whole market. "For young artists, auctions are a tough way to have their market tested," concedes Cheyenne Westphal of Sotheby's. "Sometimes selling or going unsold comes down to a piece's treatment in the catalogue." As a protective measure, galleries with strong cash flow often attend auctions themselves. New York dealer Larry Gagosian, for example, recently paid $96,500 (£62,500) for a work by the young British painter Cecily Brown below its $100,000 (£65,000) low estimate at Sotheby's New York. "We try to defend our artists at market," says Wright of Victoria Miro. "Either we bid ourselves, or we ring up the artist's collectors from our gallery and encourage them to bid. At least if they buy it, it's in the hands of someone we trust."

Rule 6 Galleries Never Hold Clearance Sales

Just like musicians, gallery artists can experience a wide range of career trajectories. Some build very slowly, peak in middle age and sell steadily until their death. Other artists are discovered before even finishing art school, get a huge feature in Frieze magazine, find themselves the subject of a gallerist bidding war, do one big solo show and then disappear.

But unlike a store owner selling déclassé trainers or last season's tech toy, art dealers don't just liquidate their stock. "A gallerist really can't drop an artist's prices," says Aileen Hovanessian, who worked at White Cube before joining Phillips de Pury & Luxembourg. "It signals an ebbing away of their faith in the artist." The real issue at hand is not the artist's feelings, but those of their collectors, who might suddenly suspect the gallerist has freighted them with dodgy work and stop buying from the dealer. What usually happens, thus, is an unpleasant withering of the relationship between artist and dealer. Scan down almost any gallery's past-exhibitions list and you'll find artists who showed every 18 months, then suddenly not at all. Chances are their market's cratered. The other tip off: major changes in format. "There are tricks for artists with declining markets, if they're willing to play along," Baer explains. "You can change the edition size, for example, so you're selling 10 for $20,000 (£13,000), instead of three for $50,000 (£32,200)."

The trouble with never dropping prices extends beyond artists who founder. When artists are doing well, especially at auction, galleries can start feeling a tremendous pressure to up their rates. "The problem is that most artists have a market peak that lasts three or four years," says The Project's Liu. "You have to take that into account and resist too much boosting because you can't lower their prices later."

A classic example of soaring gone sour is Julian Schnabel, the egomaniacal 1980s star turned film director. Today his auction record stands at $361,000 (£230,000) – roughly £100,000 less than that of London painter Jenny Saville, who was still a schoolgirl when Schnabel was reportedly proclaiming himself one of the greatest 20th-century painters alongside Picasso and Jasper Johns. The next star to fall? Baer and others are pointing at Hirst. "He's slowly going out of favour," Baer says, citing middling recent auction results. "You can't sustain a market by being the shocking new artist forever." ■

The Road to Basel

How one Isaac Julien video became 10 triptychs

UK videomaker Isaac Julien counted among the first artists selected for this summer's prestigious Documenta event in Kassel, Germany – no surprise, really, given his long association with Documenta artistic director Okwui Enwezor, the Nigerian critic and curator. Julien had proposed Paradise/Omeros, a lush meditation on race, sexuality and the West Indian diaspora, with a $250,000 (£160,000) budget.

Unfortunately, though Documenta rates high on intellectual rigour, the event can barely fund itself, let alone its artists. After New York's Bohen Foundation generously decided to underwrite the production – filmed in Saint Lucia and England – Julien's gallery, Victoria Miro in London, decided to capitalise on the Documenta selection. Not only would it sell four DVD copies of the video at £50,000 apiece to museums, but it would also issue a series of large-format photo-triptychs (above), using images drawn from the filming. Thus, during the video's editing in February, Julien and gallery director Glenn Scott Wright also sorted through hundreds of potential combinations. In the end, 10 triptychs emerged.

Then came a critical question: How should they be priced? Julien had never sold such sets before, previously only producing smaller video stills and photogravures, for prices ranging from £1,000 to £5,000. Using textbook supply-and-demand principles, the gallery decided upon a graduated price structure: the first triptych sold from each edition would be the cheapest, at £10,000; the fourth one – completely identical – will cost £20,000. Odd as that might seem, explains Wright, the strategy is aimed at rewarding collectors for showing commitment to Julien's work.

Though the triptychs represented a jump in Julien's ancillary-work prices, Wright felt confident. Whenever an important non-market event – such as Documenta or the Venice Biennale – takes place in Europe just before Art Basel, major collectors swarm in from all over the world. What's more, Julien ranked among the most established Documenta artists. And he only sells new work through Miro.

No one was officially allowed to see the entire work beforehand but the gallery did publicise its imminent revelation. Then, during Documenta's opening days, it gave a dinner in Julien's honour, inviting a "core group" of about 40 collectors, museum curators and directors, and journalists.

In Basel, a Paradise/Omeros triptych dominated the outside wall of the gallery's stand to pull in collectors and the pieces were snapped up by buyers from the US, Europe and Australia, where a recent Julien retrospective pumped up his market. "Once we got the response from people at Documenta, I knew sales would go well," Wright says. "Collectors kept asking me what we would have by Isaac at Art Basel." ■

The Hammer v the Velvet Rope

Why galleries and auction houses are at war

When most of today's contemporary-art gallerists entered the trade, auction houses occupied a distant province in the industry's landscape. Dealers thrived from controlling the so-called secondary market – selling work they bought at steep discounts from their own shows or brokering deals between collectors for hefty commissions – with no further cut going to the artists.

Those halcyon days ended in 1998 when 35-year-old Philippe Ségalot, a long-haired Parisian, took over the Christie's contemporary art department. Ségalot selected artists nobody else deemed ready for auction, then fetched prices other experts imagined impossible. After briefly poo-pooing Ségalot's tactics, his competitors at Sotheby's and Phillips (now Phillips de Pury & Luxembourg) scurried to catch up. Today, auction houses and galleries engage in a perpetual range war, complete with espionage, treaties and accusations of skullduggery.

"When I started in 1990, we never touched anything less than 10 years old," recalls Cheyenne Westphal, head of Sotheby's contemporary department. "Now the minimum is two years." There are frequent exceptions even to that industry-wide rule of thumb; in November 2001, for example, when Phillips de Pury & Luxembourg sold one of Egyptian artist Ghada Amer's embroidered canvasses (above) for $40,250 (£26,000), it was perhaps 18 months old.

For galleries, this spells disaster. "I hate the auction houses," says one prominent gallerist, pretty eyes flashing. "They're jackals who don't care about the artists. The price estimates they set are often very wrong. And the catalogue descriptions can have major mistakes."

Auction houses are equally wary of gallerists. "We only tell the dealers anything after we have a signed contract consigning a piece to us," says Aileen Hovanessian of Phillips de Pury & Luxembourg. "Otherwise they might try to stop the sale. When I do call dealers about a piece, I can almost hear them scanning their memory to figure out who bought it originally."

Punishment often follows. Galleries loathe collectors who "flip" work into auction too fast; some New York dealer's invoices now include a line invoking a right of first refusal if buyers decide to sell. Such covenants likely have little legal standing, merely spelling out what were once gentleman's agreements. "These contracts are like prenuptial agreements – implying, 'I really like you, but I don't really trust you,'" says New York gallerist Sean Kelly. "When I sell work to a collector, I accept that he can do with it as he sees fit. Flipping it at auction is their right. But it's also my right never to sell them another piece." ■