Brief Subjects and Tasks, by date


Grading: based on 4 Tasks (at 10% each = 40%), plus an original research paper.
NB. Tasks are to be completed as team projects: (max. 3 persons), whereas the research paper, except under special circumstances, is to be completed by one or two persons. As part of assessing your contribution and how much you personally acquire from the course, 10% of the grade will be my sense of your engagement and active participation (raising issues/questions in class, the sophistication of your research work, and so on. I particularly wish to see your analytical capability growing over the course of the semester, and I will value independent thinking and originality (“flair”). Tasks are due on Jan.20, 29, and Feb.17 and 24.

Approach: we shall examine observed behavior on the part of the key players in art markets – dealers and gallerists (DGs), auction houses (AHs), collectors, artists, and perhaps art advisers – and will be seeking explanations thereof. I presume agents in art markets are basically self-interested and rational, but the special nature of art objects and certain peculiarities of art markets themselves tend to issue in behavior that seems somewhat surprising, or at least out of the ordinary.

Underlying everything is my assumption that art is something we find desirable. Since I am particularly concerned with visual imagery (paintings mainly), I will spend some time discussing what experimental psychologists are finding out about what it is about visuals that gives us sustained and self-enhancing pleasure.

As noted, I assume rationality in agent behavior. My aim is to address the nature of art objects and conditions in art markets and infer what would be rational under the circumstances. There are many oddities in the behavior of those involved in art markets but a lot of what looks odd turns out to be quite rational given the nature of art objects themselves. Chief among the characteristics of art objects is that they are, or can be represented as being unique. I shall speak of their quasi-uniqueness.
If each art object is quasi-unique, this means that the supply curve of each is a vertical, at 1 on the horizontal axis. It also means that there is no demand curve as such (make sure you grasp why this is so).

Moreover, in art markets there is no single market-clearing or equilibrium price for each piece of art. For buyers vie with each other and each buyer brings both a certain level of income that can be spent without harming his or her wealth position and a certain strength of fancy (or desire) that they feel for the artwork. (Fancy is Adam Smith’s term.) This means that there are, in principle, many mutually satisfactory prices.

DGs can exploit this to their own advantage: there is competition among possible buyers but only one supplier, the DG. Price discrimination, generally, is not frowned upon unless it is associated with squeezing monopolistic gains out of buyers. But in art markets, though such squeezing is a possibility, DGs do not hold all the cards. Those operating as gallerists promoting particular artists in the “primary” (or first sale) market are constrained by the fact that artists can and do jump to another gallerist. There are no fixed contracts and agreements can be undone unilaterally. Nevertheless, as far as potential buyers are concerned, DGs do have considerable power. They prefer collectors who will buy from them again and again; and they detest buyers who might turn around and sell something they have only recently bought. DGs therefore have lists of prospective buyers, ranging from the black (established and reliable) to the grey (novice, not much of a track record) to the red (avoid at all costs).

Thus potential buyers may be taken advantage of to some extent, and this is more true of novice buyers, who have little power until they are deemed to be insiders. Moreover, in the present market for (especially) Contemporary Art, a DG has power because simply because this art has become very collectible and more and more wealthy individuals are joining the ranks of prospective buyers, while the supply of choice art objects, new or old, is limited. Where demand exceeds supply, it is the holder of desired art objects who pulls the strings, and it is perfectly rational under the circumstances for a DG to be a discriminating seller.
The following is my translation of the advice sent by the Goedkindt brothers, established DGs, one in Paris, the other in Antwerp, to their cousin, Chrisostomo Van Immerseel, a novice dealer, in Seville, in the early 1620s. Van Immerseel was supposed to explore the demand for Flemish paintings in Seville, an untried market for the Goedkindts. To cover costs and give his uncles and himself a good return on average, he was urged to secure margins on quality paintings in the range of 100%+. To this end they advised him not to sell to the first person who visited his gallery and expressed an interest in one or other of the better paintings he had received, but to favor those with real money; these will usually be merchants. (The number of Flemish merchants in Seville in the first half of the 17th C. was never less than 200!) Allow interested merchants the freedom to come truly to love a painting that also attracted them at first sight. [I am fudging a bit here, but I think it is consistent with the tenor of the advice]

Put yourself in Van Immerseel’s position. (i) What would you do to carry out your uncles’ advice? What would be both necessary and sufficient for your strategy to work? (ii) Is it possible to capture Van Immerseel’s strategy in the supply-demand diagram we developed above for quasi-unique objects? Can you show how the diagram or some element in it would be altered by the strategy recommended by the Goetkindt brothers?

We will discuss this in class on Jan.13. Note that a New York State Law Requires DGs to display or make available on request a price list for the art on sale. This law is honored mainly in the breech. Why do you think that is?

**Thurs. Jan. 15.** Recent challenges to the strong monopoly positions of DGs in contemporary art markets.

Marc Glimcher, the director of Pace Gallery in New York, suggested not long ago that the traditional business model of dealing in art has become outmoded, yet most dealers cannot adapt to the changed circumstances that render their model unsustainable [*The Art Newspaper*, # 252, section 2 (December 2013), p.15]. These comments were made to a reporter and need to be unpacked to get at their (probable) meaning. Here is my version. Glimcher appears to have been drawing
strong conclusions from two relatively recent changes that have occurred in art markets.

Two events in September, 2008 signaled these changes. (1) First, the potential downside risk for DGs in having no written contracts with ‘their’ artists was exposed when the prominent artist Damien Hirst suddenly left his gallerists, Gagosian and White Cube. At the same time, (2) Hirst went directly to his buyers, using Sotheby’s as intermediary: they organized a sale of his work that included new pieces. This last challenged the unwritten rule that auction houses deal only in previously-owned paintings and other art objects. Thus two challenges in one!

In a sense the Hirst-Sotheby’s collaboration in a sale that included new work was never going to amount to a serious breach of traditional norms, since very few artists can produce enough new work to satisfy the demand. Thus the Hirst-Sotheby’s collaboration did not force DGs to abandon their practice of keeping waiting lists (black lists, and so on).

What did change was the longstanding norm that new work was a no-go area for AHs. It has become more common for AHs to mix new work and previously-owned art objects in auctions. Change came also – and stuck – in that more artists have unilaterally changed their DGs and active poaching of artists from the side of the DGs themselves has become more accepted.

This last has gone along with a challenge to the old bricks-and-mortar sort of DG, in the form of online sites offering paintings for inspection and sale. AHs too have felt this challenge and now offer real-time online bidding and even their own online sites for display and sale, outside the traditional live auctions.

Some observers bemoan these changes, arguing that the ‘free agency’ assumed by artists affects DGs differentially, depending on their size. Established, large-scale DGs like Larry Gagosian – last time I checked he had 12 galleries in 8 cities around the world – have the means to attract high-performing artists to themselves, so that poaching negatively effects mainly the mid-career DGs of limited means. This is a question of relative market power. For the mega’s – actually I know only one, Gagosian – with a presence in more than three locations – can and do “publish substantial catalogues, help finance public museum shows and occasionally produce
museum-quality exhibitions in their own spaces” [remarks by Candice Worth, New York-based art adviser, *The Art Newspaper* #252, as above]. Smaller DGs are following Gagosian, though on a more limited scale. But not many can do even this, so that contemporary art markets are becoming two-tier in structure, with increasing numbers of less viable small-scale DGs below the few multi-nationals. As always when a market comes to be dominated by a few, it is appropriate to ask whether this doesn’t tend to the accumulation of *market power* in the hands of those few. In the US at least such accumulation of power tends to attract attention from the Anti-Trust authorities. But perhaps art is too small an industry to count…?

Some also fear a possible undesirable impact on quality, arguing that what is lost in these changes includes the “support system for the type of art that isn’t quickly branded, leaving a legacy comprising only commercially-successful art” (ibid., comment of Ed. Winkleman, co-founder of the video art fair *Moving Image*).

While I share some of the concern over these developments, I think it is also possible that certain of the changes described have a positive aspect to them. DGs with a presence in several cities, for example, satisfy more completely the needs and wishes of a new breed of collector among the growing company of high net worth individuals (those in the top 0.1% of the wealth distribution). They make it more attractive for collectors in this wealth category to hop from fair to fair, as a way to keep up with what is being made and to register their interest. The larger-scale gallerist also has the means to ensure some measure of price stability and/or appreciation over time. (More on this element later).

I have focused here on two features of dealing in a changing world. However, there is also a third feature that I do not see others addressing, but which I believe to be a crucial limitation of the traditional business model of the gallerist/dealer, whether large and established or new and small. Dealers and especially gallerists choose which art and artists to represent and promote, committing time and capital to enhancing the likelihood that they have chosen well. However, unlike financial markets, *art markets do not have tradable instruments that would allow bets to be hedged*. There are price indexes for various art sub-markets, but no tradable instruments that would allow one to “buy the market” in those sub-categories, as is
possible, for example, with the S&P 500. One cannot short a painting or a particular artist, and there are no tradable futures contracts for art. Thus the choices made by the dealer/gallerist, as by the collector/investor in paintings, are one-way, or uncovered (unhedged) bets.

This is partly because of the uniqueness of art – art, after all, is more like houses than nail scissors: each piece, like every single-family house, is somewhat unique. But art markets are also relatively illiquid. There exist price indexes of single-family houses in the largest US cities (commonly known as Case-Shiller indexes, after their co-inventors), but there are no tradable futures on those indexes, hence they cannot be used in hedging operations. Robert Shiller, one of the inventors of house-price indexes, and co-recipient of the 2013 Nobel Prize in Economics, in 2006 tried to float futures contracts and options on future house prices (for single-family dwellings) in the ten largest US markets. He failed because the market was too small. The number of shares portfolio managers could make trades in without causing large movements in price was too small to make it worth their while to take positions [Robert J. Shiller, Finance and the Good Society, Princeton, 2012, p. 62]. Shiller thinks of this as a kind of illiquidity.

Art markets suffer from illiquidity in the same sense – there is no continuous trading in shares of paintings, though a couple of attempts have been made in China – but also in the sense that it takes time, costs money, and there is no certainty about price achieved in the next best alternative, namely, auctions.

The absence of hedging and the illiquidity of art markets means that there is an extra risk premium associated with being a dealer or gallerist in art. DGs may or may not invest in art directly, but they do invest in artists, and in expensive buildings in which to house and exhibit art, as well as in costly attendance at and moving paintings to selected fairs around the world. This is part of the traditional business model for gallerists/dealers in art markets, and it is one reason to question the wisdom of getting into the business in the first place. In this sense Glimcher’s suggestion that the traditional business model of gallerists/dealers is “quite uneconomic” seems right. But again, perhaps some scepticism is in order: I am not aware that new gallerists and dealerships in art go out of business more rapidly.
than is the case with other product lines. **This would make a splendid research project – if there are data to be found!**

There is in fact a fourth change challenging the old model of bricks-and-mortar DGs, namely that display and sale of art is increasingly effected online. We shall need to explore this fourth element further as we progress through the semester.

However, as stated in class, I would like to begin the discussion with you on January 15. You should have Googled the interview by Andrew Goldstein (Artspace) of renegade collector/advisor Stefan Simchowitz. Read also the piece in the New York Times with a title like The Great Satan of the art world. This will show up if you Google Stefan Simchowitz.

**TASK 1:** for submission in class **Tuesday Jan. 20.** Please **use one sheet only, typed and with 1.5 spacing.**

Read the article by Nick Paumgarten, on dealer/gallerist David Zwirner, in the December 2, 2013 *New Yorker*, esp. the story recounted on pp.44-45. The takeaway lesson from this tale is that DGs not only practice price discrimination among clients (which I regard as rational given the uniqueness of art objects), maintaining black lists, and so on, **but they compete fiercely with one another.** Nevertheless, like so much in the art world, this intra-DG competition is somewhat peculiar: as noted by Paumgarten, **after stabbing one another in the front (not in the back), dealers go to dinner together.**

**Your task:** assuming that dealer/gallerist competition may be thought of appropriately in Prisoners’ Dilemma terms, (i) Develop a numerical payoff matrix for a Prisoners’ Dilemma game with a dominant strategy for each of two players, A and B, considered separately. **[Your matrix does not count in the one-page limit.]**

If the options are *to poach or not to poach*, make your numbers such that the dominant strategy for each player is to poach. Let your numbers also show that, improbable though it may seem, mutual poaching of artists might be a mutually beneficial behavior in art markets. And then, (ii) supply a rationale for why mutual
poaching of each other’s artists might be sustainable. It might help you to explore the analogy of free agency in professional sports.

**Thurs. Jan. 22.** Earlier I mentioned that the **multiple location DG** (or MLDG), has the means both to stabilize prices of the work of artists they represent and to more or less assure investors that those prices will rise over time. One element lying behind this suggestion is the fact that the MLDGs have the means to influence prices. The ‘large’ dealer/gallerist might ‘**ramp**’ the prices at auction of selected artists he or she represents, or ‘**buffer**’ them – see definitions given below – or might even offer attractive ‘**trade-in terms**’ on earlier work by his or her artists to encourage collectors to shift to more recent and more costly work. Note that ‘large’ here, being a relative term, may apply either because the MLDG is absolutely large or the market itself is quite small. It is easier to identify instances of ramping, buffering or special trade-in terms in a market that is absolutely small, and I will offer you some evidence from work by colleagues for the Australian contemporary paintings market of the 1960s (favorable terms on new paintings if old are traded in) and the 1990s (ramping and buffering).

Look at the graphs (posted) of **ramping** in the market for Australian Contemporary art. The artists involved had a minimal or minimally successful record in auctions, but suddenly their prices shot up, with no apparent cause. Behind the scenes, the sudden jump in prices is the work of a dealer who decides that artist X will be the next big thing and to that end has stocked up on work by X. At a certain point the dealer puts a few pieces by X in auction sales, buying them himself or herself for unusually high prices. The dealer informs the press that the high prices are evidence that X is indeed the best coming thing, and hopes that the price rises he/she has initiated will be sustained by others who take their cues from the press coverage.

**Buffering** involves a DG jumping in when a work by artist Y – ‘their’ artist – suddenly appears in the catalogue of an upcoming auction, the vendor being a collector. [As hinted at earlier, this is traditionally regarded as inappropriate behavior by a collector, and some DGs ask collectors to whom they are willing to sell
a piece to sign a document stating that they will never offer the work at auction without giving the dealer first refusal. (To my knowledge, such restrictions have not been tested in court.) To avoid the risk that Y’s price trajectory might dip if the work at auction fails to elicit strong bids, Y’s DG stands ready to buy the work by Y at whatever price is necessary to maintain the appearance of steadily rising prices for Y's work. I do not have actual evidence of buffering, though it is widely acknowledged that it happens.

Study the table I of economist Roy Webb (copies in class) involving trade-ins offered by some Melbourne DGs in the 1960s to selected collectors and study the numerical example he uses to show that in this manner DGs might contribute to an artificial boom in a small, self-contained art market.

**Task 2: is anyone hurt by Ramping, Buffering or DGs offering “trade in” discounts? (for submission in class Jan. 29)**

**Tues. Jan. 27.** I wish to discuss with you in class the original behavior Webb identified in the Melbourne market of some DGs offering price reductions on new work provided the buyer turned in earlier works by that same artist – like an automobile trade-in. Issue: what if requisite for such behavior to an art market boom or bubble? Where else are those terms sometimes applied (among emerging markets)? Why?

**Thursday Jan. 29.** Besides discriminating among potential buyers, a perfectly reasonable behavior, DGs sometimes engage in quite gratuitous and egregious behavior, such as ‘forgetting’ to inform one of ‘their’ artists when one of their works is sold; sticking an artist with hard-to-verify costs for exhibitions and thereby lowering the tacitly-agreed percentage on sales (for beginning artists usually 50% after costs – real and invented).

We will discuss various egregious behaviors by DGs in class. I shall distribute material for you involving a well-known Chapel-Hill and Durham dealer. An oddity
of this case is that some artists, although cheated out of sale revenue by this dealer, defended him. Explain that!

I might also discuss a recent case involving fake works and the margins that can be calculated from court documents. One might argue in defence of egregious behavior by certain DGs that their risks and costs are considerable and their usual profits tiny. At the same time, while winning bids at auction are quite unpredictable (or so I suspect), DGs have considerable leverage over their buyers and such evidence as we have – almost none! – suggests that margins can be substantial. (And, of course, margins on sales do not translate into profits)

Though not exactly relevant here, a great research project would be to use the archives of a successful (and I think honest) NYC bricks-and-mortar dealer (one Betty Parsons, 1940s-1980s: all correspondence, names of artists, stock, payments made and received is now online). Tedious work but a great archive – and great material for a research paper – of how it was done half a century ago.

**Tue. Feb. 3.** Today we move on to auction houses (AHs). But to start with, let me mention that throughout modern history dealers have formed and operated as rings to keep winning bids at auctions artificially low, to their advantage and at a cost to AHs. Rings, however, are rarely prosecuted, because ring members – at least in England – need to be caught in the act of dividing up their spoils and they take good care to see that this doesn’t often happen.

Read the (posted) article by myself and Hans Van Miegroet on a Paris ring of the 1780s, to get a sense of the sophistication of such rings, even back in the 18th C. And there are other bad behaviors that auction houses must struggle with, such as winning bidders refusing to pay for the objects they win.

Aside from these two sorts of problem there is a difficulty that afflicts auction houses along with all who deal in creative products (e.g. films, theater productions), namely, that outcomes cannot be predicted for individual products. This is part of what is called the “nobody knows” property of creative industries. Read the paper by three former students (posted) on hammer prices at auctions of Australian
Aboriginal Desert paintings relative to pre-sale published estimates, for a sense of how serious a problem this can be.

**TASK 3, for submission in class, Tues. Feb. 17 – yes 17th.**

(i) Choose a *single art auction* within the past two years: any sort of art, any auction house, anywhere: anywhere, that is, where you can get auction prices. Sotheby’s (and Christie’s?) sites have lots of auction results.. Construct a histogram of the differences between hammer price (including *buyer’s* premium) and mean estimates for your sale. (If the differences are very large you might use logs, otherwise just create ratios.]

**Ideally** – if you have the expertise – (ii) use a program to generate from a whole range the *mathematical function* that most closely fits your histogram. Question: is that function the probability density function of a *Normal* distribution? Thus, could the density of observations have been predicted in the same way as is possible for a Normal (using as measure the percentage of observations that fall within one, two or three standard deviations from the mean)? **However,** if you cannot use the program to generate function of best fit, then simply gain a visual intuition as to what is happening, chart sensible quantiles of your differences against those that would be generated by a Normal distribution. This is called a QQ chart. It gives you a nice visual image of your distribution versus that of a Normal, for which the quantiles will lie along a straight line.

But in terms of required work, (iii) create a chart of the percentages of sale revenue contributed by extreme differences – those in the 95th percentile and above – as in the chart in the circulated paper by some former students).

A conclusion that probably will emerge from your examples is that the AHs are not using their pre-sale estimates as predictors of what will happen in the auction itself. But in that case, do they not know what they are doing? Or do they have some more subtle purpose in view? Rachel Pownall argues that even if overall the pre-sale estimates are off, this might perhaps be much less for the top 10% of hammer prices. (iv) Check this for your auction.

NB. This is a time-consuming task so use 3 pages for your answer if necessary.
**Thurs. Feb. 5.**

Today I wish to discuss with you some of the questions that arise out of the changing business models being tried out by the major AHs.

One of these is the role of **in-house guarantees**. Is this just a form of ramping? Do guarantees raise prices? Just how are they supposed to serve an auction house?

Another is the matter of **transparency**. For an AH which holds traditional auctions but also engages heavily in private treaty sales, the public has auction prices as the only published data, whereas the AHs have both these and the prices from their private treaty sales. **This creates a certain asymmetry of information between AHs and the collecting public.** Together with an AH’s use of in-house guarantees as a way of signaling where the market is, this places the collecting public at some disadvantage in terms of knowing just where prices are and are heading.

The emerging business model looks like a hybrid: AHs act somewhat as price setters in their use of in-house guarantees, and in their private treaty sales, but as price takers in their open outcry auctions. How does this benefit them? Is it in fact the case that price volatility is less in auctions with in-house guaranties?

Does the hybrid system favor the very wealthy collector over those less wealthy? For, bear in mind that a wealthy collector can negotiate with an AH on the guaranteed price, just as the consignor negotiates with the AH over reserve prices and guarantees.

**Tues. Feb 10**

A question increasingly asked is whether art is a good investment. For this class read Rachel Pownall (article: results posted): she wrote as Rachel Campbell when she wrote on this topic). What exactly does she argue?

**Thurs. Feb. 12.**
We shall explore in class the nature and significance of Pownall’s findings. She tends to favor boutique art fund investing, but Art Funds, boutique or otherwise, have not been survivors in the last (tumultuous) decades.

**Tues. Feb.17.** We will discuss your Task 3 results.

**Thurs. Feb 19. Task 4. For submission Tue. Feb 24. Why do collectors buy art?** Although Pownall (Campbell) urges that art is a good contracyclical component to have in one’s portfolio, she and others caution that for a variety of reasons – (i) what reasons, specifically? – art should not comprise more than a small fraction of ones assets. (ii) Read Ben Mandel (ref. posted) on art as a Veblen (conspicuous consumption) good.

**Thur. Feb. 26. Task 5. For submission, Tue. March 3.** Artists. The evidence from periodic Australian surveys (Throsby & Hollister, details posted) suggests that very few visual artists make enough to live on and are forced to devote some of their time to teaching or other work quite unrelated to art. This is in a sense a waste of social capital. For, if it is true that we love art in some form or other, and that it both gives us intrinsic pleasure and is also self-enhancing of such pleasure, then art functions in society as a sort of positive externality, generating more pleasure than it costs (unlike activities that merely ease a pain or fill an immediate functional need). This constitutes an argument for more public resources to be devoted to the arts. **Your task. Evaluate this argument.**

The remainder of the course will comprise meetings with me on your research projects and preliminary versions of these presented to the rest of the class.