
Grading: based on 8 small Tasks (45%), plus an original research paper (completed either as an individual or team project) (45%), plus engagement, with flair, throughout (10%).

Approach: examination of the observed behavior of key players in art markets – dealers and gallerists (DGs), auction houses (AHs), artists, collectors, art advisers – and 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 tend often to issue in behavior that seems somewhat surprising, out of the ordinary. It is my aim to reach an understanding of behaviors of both sorts – the straightforward and the odd.

Jan. 14. Dealers and Gallerists (DGs). 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 rationale under the circumstances. Thus if you accept that art objects are unique or may be represented as being unique - I will use quasi-unique for short - then the supply curve is vertical at 1 on the horizontal axis. And, since there can be no demand curve strictly speaking (recall that a demand curve is the set of points indicating how much of a good you would be prepared to buy at different prices, whereas here there is just the unique good itself, no more, no less), then we have a vertical supply curve at 1 and a series of points on that curve, each standing for a different offer price or demand price for the object.

Each offer price is backed by or associated with a particular level of disposable wealth/income and a particular intensity of desire for the object. Prices, in other words, are determined by wealth and ‘fancy’ (Adam Smith’s term).

A DG (I assume) aims for the highest offer (demand) price, but, since each such offer embodies a particular wealth constraint and fancy, a DG is involved in a
negotiation with every potential buyer, each of whom is in some degree unique. The rational DG therefore will rank potential buyers by the relevant factors.

This is price discrimination, which is generally not illegal unless it can be shown to led to monopoly advantage. In art markets it is the DG who holds a particular art object; so the starting position, for prospective buyers interested in an art object held by a DG, is one of monopoly on the part of the supplier.

Wealth and desire are basics in the consideration by the DG as to which of the prospective buyers he/she is willing to sell. But there are also other factors. These include whether the potential buyer is an old-established client or a relative newcomer, and whether or not they can be relied upon not to put the art object up for sale at auction or, if they decide to do so at some future date, whether they can be depended upon to give the DG first right of refusal to repurchase it. DGs, therefore, keep 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 we have a situation where there may be multiple equilibrium prices for a single art object, depending on the specifics of the several, maybe many, specific negotiations involved. And, it will be the DG who decides which offer to accept. A DG holds this power in contemporary art markets simply because art has become a collectible and more and more wealthy individuals are joining the ranks of prospective buyers, while the supply of choice art objects 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.

In class we will read together 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, 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 (typically merchants: the number of Flemish merchants in Seville in the first half of the 17th C. was never less than 200!) and to allow them the freedom to come truly to love a painting that also attracted them at first sight.

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. Also, (ii) is it possible to capture Van Immerseel’s strategy in the supply-demand diagram we developed above for unique objects? Can one show how the strategy would take effect? Can you show how the diagram or some part of it would be altered by the strategy?

Thurs. Jan. 16. Recent challenges to the strong monopoly positions of DGs in contemporary art markets.

Marc Glimcher, the director of Pace Gallery in New York, suggested recently 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 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, with the help of Sotheby’s, who 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 norm that new work was a no-go area for AHs. It has become common for AHs to mix new work and previously-owned art objects in auctions. And change came – and stuck – also in that more artists have unilaterally changed their DGs and active poaching from the side of the DGs themselves has become 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 usual 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 Gagosian – he has 12 galleries in 8 cities around the world – have the means to attract high-performing artists to themselves, so that poaching affects negatively 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, the 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. I wonder whether this doesn’t tend to the accumulation of market power in the hands of a few large DGs and which (in the US at least) 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 of 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 collectors 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, since the chances are enhanced that they will find attractive paintings by artists whose reputations are driven, at least partly, by price appreciation and whose works therefore afford a way to complement other investments with reasonable safety, since the larger-scale gallerist also has the means to ensure some measure of price stability and 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 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. 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, recall, is more like houses than nail scissors – but also partly because of illiquidity. 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, but 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].

Hedging possibilities in art markets have not even got to the stage of creating potentially tradable instruments. But this absence of hedging possibilities in art markets means that *there is an extra risk premium associated with being a dealer or gallerist in art*. DGs do 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.**

**TASK 1:** for submission in class **Tuesday Jan. 21.** Submit one sheet, typed.

Read the Nick Paumgarten article in the December 2, 2013 *New Yorker*, esp. the story recounted on pp.44-45 (which will be available in class). 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, grey red lists, *but they compete fiercely with one another*. Nevertheless, like so much in the art world, this intra-DG competition is somewhat peculiar: as noted above, after stabbing one another in the front (not in the back), dealers, it is said, go to lunch together.

Your task: assuming that dealer/gallerist competition may be thought of appropriately in Prisoners’ Dilemma terms,
(a) Develop a numerical payoff matrix for a Prisoners’ Dilemma game with a dominant strategy for each of two players, A and B, considered separately. 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, (b) 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. Why might this be (or not be) positive for all teams in a league?

**Tues. Jan. 21.** Earlier I mentioned that the multiple location DG – 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, which I shall do, borrowing from work by colleagues for the Australian contemporary paintings market of the 1960s (trade-in terms) and the 1990s (ramping and buffering).

Look at the graphs (posted) of **ramping**: 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 that 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 X is the new best thing and hopes that the price rises he/she has initiated will be sustained by others who believe 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 documents have not been tested in court.) To avert 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.

Read the posted piece by economist Roy Webb 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**, for submission in class, **Tues. Jan. 28**

Who, if anyone, is hurt by ramping, buffering and attractive trade-in terms? [You may fill up to two typed sheets for this task, but be sure that your answers remain succinct and ordered pieces of analysis. Do not fill two sides if you do not need to!!!]

**Thurs. Jan. 30**: DGs, besides discriminating among potential buyers, a perfectly reasonable behavior, sometimes engage in quite gratuitous and egregious behavior, such as ‘forgetting’ to inform one of ‘their’ artists that some work has been sold; sticking an artist with hard-to-verify costs for an exhibition and thereby lowering the tacitly-agreed percentage (for beginning artists 50% after costs).

Read the *Independent* piece on allegations against erstwhile Durham and Chapel Hill dealer/gallerist Joe Rowand.

I wish also to 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 profits
tiny. At the same time, while winning bids at auction are quite unpredictable (see below), DGs have considerable leverage over their buyers and such evidence as we have – almost none! – suggests that margins can be substantial. (Of course that doesn’t demonstrate profitability.) A **great research project would be to use court records in the ongoing Knoedler case to calculate rates of return on fake paintings purchase and then resold.**

**Tues. Feb. 4.** 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 need to be caught in the act of dividing up their spoils and they take good care to see that this doesn’t happen.

Read the 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. This is known as 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, **Thurs. Feb. 13.**

Choose a **single art auction** within the past two years: any sort of art, any auction house, anywhere. Construct a histogram of the differences between hammer price (minus premiums) and either high or low estimates for your sale. (If the differences are very large you might use logs, otherwise just create ratios.)

Next, either (1a) use a program (available through the Statistics Lab, whose personnel will also advise you on some of the unfamiliar aspects of this task) to
generate from a whole range the *mathematical function* that most closely fits your histogram. Question: is it 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)? Or, 1(b), and better for getting 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 gives you a nice *visual* image of your distribution versus that of a Normal, for which the quantiles will lie along a straight line.

Finally, (2) create a chart of the percentages of sale revenue contributed by extreme differences – those in the 95th percentile and above – so extreme that they could not be predicted (like the one in the circulated paper).

A conclusion (I am almost certain) that 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? Read the piece by Ashenfelter and Graddy for one reasonable alternative role the pre-sale estimates might fill.

**Thurs. Feb. 6.**

AHs in art have lots of troubles, a list of which will show that they have become much more than just the legal agents of the sellers, and now compete directly with DGs, further complicating the issues of who does what in art markets and how do their interests intersect. List to follow...

**Tues. Feb. 11.** Challenges to DGs’ monopoly status.