

# Selling Out: The Financialization of Contemporary Art

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**ABSTRACT:** This project came out of a behavioral economics class I took in 2016. Behavioral economics is the synthesis of human psychology and the more formulaic aspects of economics. I used this discipline as a lens for looking at how the financial services industry exploited the contemporary art market with its lack of regulation and transparency. My aim is to show the various ways this drastic financialization has happened by discussing the various heuristics used to value art and the financial instruments that financialized contemporary art mimics. Furthermore, I have found evidence that art is being used as collateral for important assets such as pension funds. The fact that art is volatile and unregulated makes art an unreliable investment and certainly not stable enough to base pension fund values on. This is the beginning of future research that I plan to conduct in an attempt to predict the eminent collapse of these contemporary art financial instruments. I hope to present this paper outline to book publishers to elaborate my findings into a book for industry professionals.

**KEYWORDS:** art market, art investments, financialization, art indexes, art trade, art auction valuation, art as capital, art as collateral, contemporary art, art-loans, heuristics, scarcity, confidence, herd mentality, bounded rationality

## 1. Introduction

Andy Warhol once said, “Business Art is the step that comes after Art.” To many artist’s chagrin, he was correct. Since the early 2000s the contemporary art market has become increasingly financialized. With paintings such as “Interchange” (de Kooning) & “Number 17A” (Pollock) selling for a combined \$500 million in 2015 to the billionaire Ken Griffin, founder of Chicago-based hedge fund firm, there is little to deny the fact that art has entered the realm of immense commodification. At the time, these paintings were the 1st and 2nd most expensive 20th century paintings ever sold. Everyday we hear news about a new record high in art sales.

In 2014, art market sales reached a record \$68 billion, double the level of 2009 according to the European Fine Art Foundation. For comparison, that is equivalent to about one quarter of the global fashion and apparel market. Furthermore, prices for contemporary and post-war art rose 19% in 2014 (The Economist 2015). Due to this growth there has been a distinct shift in the contemporary art market from buying art for pleasure to buying art for financial investment. According to Deloitte, a consultancy firm that has recently branched out into the art world, three-quarters of art purchases are at least partly for investment. 20th & 21st century art has undergone drastic commodification, corporatization & financialization (Taylor 2012). A “whole new profession” has been inspired by the frequency of these large acquisitions. There are now “consultants who pick out paintings for their clients based not on aesthetics but on potential returns” (Economist 2015).

Contemporary art trends have gone the way of ideas over the expertise of a medium. The mastery of a craft is no longer a requirement of art (Roberts 2008). “Investors turn their attention to the market and its dynamics, neglecting goods and commodities” (Esposito 2011). Artist Jeff Koons is known for satirizing the art market through his work. His most well known piece is “The Balloon Dog” which is the most expensive work by a living artist ever to sell. It sold in 2013 for \$58.4 million.

## 2. What is contemporary art?

While the definition of contemporary art is somewhat fluid. For the purposes of this paper and any future research, contemporary art is any artwork created in the 20th and 21st centuries. This paper is not considering design as art (such as furniture). This is because “design” has an ulterior purpose. For example, in the case of a Hans Wagner chair, although it could be considered art, its primary purpose is to be sat upon.

### 3. The Players

There are three main players when one observes the contemporary art making and selling process; the artist, the auction house or gallery, and the consumer. In this section I will examine the producers and the financial intermediaries in the commercial exchange.

The art making process begins with the artist. Until recently, this has been a male dominated industry that has evolved from making art for the sake of craft to making art for the sake of money. Artists that primarily make art for monetary purposes are called “production artists”. It is fairly typical that they are not involved in the production process. Other than project ideation, these artists usually become celebrities in their own right. Damien Hirst & Jeff Koons are examples of production artists. These artists work out of places called “factory studios”. Often they hire student interns who work without pay.

Once the artists have produced the artworks, the auction houses and galleries take over. They are the commercial intermediaries that connect collectors to artists. In many ways they hold sole responsibility for driving values up to unprecedented levels. The duopoly of New York auction houses, Christie’s and Sotheby’s, is comparable to the New York Stock Exchange. The auction houses provide a space for collectors to offer their collections for sale in a highly competitive environment.

On the other hand there are the galleries. The first gallery innovator in the realm of financialized art was Larry Gagosian. He strategically built sixteen galleries in every major financial center of the world.

### 4. Valuation

Before examining the specific valuation techniques that caused art prices to skyrocket, we must first define the behavioural economics context in which I examined the art market.

Heuristics are mental shortcuts that humans use to simplify decision making. They are used to substitute a difficult question with a simpler question (Kahneman 2003). These tactics can be used for benign outcome or to lure buyers in a certain direction. Consumers are “nudged” into doing and believing things that they otherwise would not have considered. Heuristics have the capability to “occasionally send us off course” (Tversky and Kahneman 1973). I find this to be true in the realm of financialized art. Below I will enumerate the heuristics that are involved in determining the value of art.

Anchoring & Focalism is a heuristic in which the seller uses a specific target value as a reference point (the “anchor”) and subsequently make adjustments in the negotiation process. Auction houses such as Sotheby’s and Christie’s often set very high “estimates” of the works they are selling in order to stir speculation.

The representative heuristic describes the fact that the more one sees certain information, the more likely it seems it will happen. Although this information may be misrepresented in its frequency, people ignore reason and continue to think in stereotypical terms. Art typically appreciates with time, thus collectors assume a positive outcome & low risk when evaluating an investment. Now that art is financialized, can we trust that assumption? Simply because the past has shown that growth and time are positively correlated in terms of art, investors should not ignore that the market is actively changing.

Herd Behavior is the tendency of individuals to mimic the actions of a larger group. Just as a herd of cattle moves in a group towards water and food, traders do this in the stock market and subsequently, art collectors do this in the art market. Stock market bubbles start with frenzied buying en masse and end with vast selling. Investors join the crowd rushing to get in or out of the market. Herd Behavior has caused the surge in art prices since the early 2000s. Herd behavior facilitates growth when value is largely based on the speculation of future prices. This is a problem because as confidence in an artist goes up or down; the value of their art can fluctuate drastically. Often confidence is affected by unwelcome news coming out about an artist’s personal behaviour, therefore tarnishing their image as an artist. If we look toward artists such as Picasso or Gauguin or Caravaggio, the value of their art has tumbled in recent months now that we are reckoning with the fact that these male artists didn’t treat their female models very kindly. Even the recent sexual harassment allegations

against Chuck Close forced The National Gallery to postpone his retrospective, which is something that traditionally drives the value of one's art up immensely (AP 2018). The effect of this exhibition closing before it even opened can only be a chilling one.

Consumers reach conclusions based on the “framework” in which a situation is presented; one's environment shapes one's choices. This is called framing.

Galleries presenting artwork in a conspicuously opulent way may entice a certain economic class of buyers to spend. When an environment of exclusivity is achieved in both galleries and auction houses, the clientele will reflect that.

Beyond the upscale framework that fine art is often presented in, auctioneers use tactics such as “chandelier bidding” to drive prices up. This is simply when an auctioneer points to the chandelier in the room between bids and pretends someone has raised the bid higher. This drums up excitement and competition among active bidders causing them to purchase the work for a manipulated higher price.

Scarcity assigns value based on how easily something could be lost, especially to competitors. Auctions create a competitive environment in which investors may buy out of zeal rather than rationale. Additionally, artworks are mostly one of a kind. The very nature of art as a creation makes it such that scarcity is a relevant heuristic. There are only so many works by a particular artist and therefore the unavailability of these works can be used to drive competition and higher prices to obtain the work. Scarcity disrupts the basic tenets of supply & demand so that an equilibrium price is never achieved. In a normal market situation, there's an amount of products eventually supplied to satisfy an amount of demand for the product. Where those two factors meet determines the ideal price and quantity, called “equilibrium”. In the case of art, there's only one unique product ( a quality of one) that is demanded by only a small number of super rich consumers which can cause prices to skyrocket beyond the true material or rational value.

## 5. Art's Use as a Financial Instrument

There has been “a pattern of accumulation in which profits accrue primarily through financial channels rather than through trade and commodity production” in the general economy, that is reflected in the art market (Krippner 2005). It seems that art is being collected to assemble financial assets.

Investors manage their art collections in the same way they manage their financial portfolios (Taylor 2012). Bundling into what are called “lots” is a common way to avoid inherent risk when investing in financialized art. Collectors will purchase a group of artworks for a single price knowing that if one artist falls out of favor and their price plummets, they still have the value of the others in the lot. This is similar to how financial advisors typically advise investors to buy a broad range of diverse stocks to minimize risk.

In this context, art is no longer a consumer good, but rather a financial asset purchased for speculative purposes. The value of a particular work is determined by its price performance within a time frame relative to other works of art held by an art fund (Taylor 2012). The praxis of buying into risky financial instruments to make a profit from short term market fluctuations is also observable in the art market. The practice of “flipping” is now somewhat commonplace (Kazakina 2014). Investors purchase artwork by undiscovered artists for low prices then resell the artists works as a series in order to boost their value and make a profit. The quick reselling of multiple works by one artist at a significant profit causes speculation as to what the future growth in value will be.

Value is “generated through a circulation of artworks in the fashion of derivatives” (Ivanova 2016). The process of buying and selling certain works repeatedly drives up value to the point where the value is no longer related to the artwork's original materiality or aesthetic contribution. The art market's financialization “exhibit(s) similarities with those of financial derivatives (i.e., contract-based financial instruments that derive their value from an underlying asset)” (Ivanova 2016). Deloitte is making the art derivatives market a reality by creating art-based derivative products as Contracts of Future Sales that are “standardized derivative contract[s] based on specific artworks scheduled to be auctioned at top auction houses” (Deloitte 2016). These instruments were approved by the UK Financial Conduct Authority in Feb 2016, but their report admits a “lack of transparency” (Ivanova

2016). This lack of transparency may be because private sales are under-regulated and out of the public eye.

Bundling securitizes artwork much the same as how Collateralized Mortgage Obligations securitizes mortgages (Taylor 2012). Like mortgages, works of art are bundled and sold as shares of a hedge fund (Taylor 2012). In addition, instead of owning a whole work of art, investors can own an undivided interest in a group of artwork or a very highly valued single piece of work. In early 2018, 25,000 individuals purchased 40,000 \$50 shares of Picasso's *Musketeer Bust* (1968) in the hopes that the artwork's value would rise (AD 2018). This is reminiscent of tranching mortgages. Another example of this is Damien Hirst's "For the Love of God" which was sold to an anonymous investment group in 2007 for \$100 million. The sculpture is made from an 18th century human skull and 8,601 diamonds. Hirst is known for making art specifically for financial markets. It is conceivable that art investors could sell their shares, creating secondary and tertiary markets that could fail.

For many financial managers, art serves as a diversifier for investments. Artworks have been exemplified for their opacity and illiquidity for many years, but that cannot be true when art is turned into a financial instrument and sold for its financial value and not its aesthetic value. Art has tangibility which differs from the abstract financial instruments that are commonplace for investors (Economist 2015). Often called "the secret industry", because there is no transparency of information, we don't know much about the industry. This makes the art market an efficient form of discreet investing. There is little to no regulation on the market, so insider trading is commonplace. This gives an unfair advantage to those in the know, directly competing with the concept of an open market.

Art-secured lending has emerged out of the public eye. Deloitte, which now offers "private wealth art-related services," claims that "69 percent of wealth managers said their institutions now offered services linked to art-secured lending." These artworks could then be used as collateral on loans. 53% of art buyers borrow against their collection to fund the purchase of more art. Buying art has become a discreet and mostly unregulated way of leveraged investing. These investment acquisitions can be made in a form of "private purchases."

One of the more alarming uses of art as collateral is in the realm of pension funds. There is evidence that organizations are using art as collateral in the realm of pension funds. The first instance of this was in 1989 when The New York Times got wind of a \$65.6 million sale of artworks by the British Rail Pension Fund. At the time it was the only large pension fund to enter the art market to supplement already acquired conventional investments as a hedge against extremely high inflation in Britain (Trucco 1989). More recently in 2014 Detroit floated the idea of mortgaging the city's collection of art to exit bankruptcy and fund a major pension gap.

## **6. Financialization transparency bubble**

The contemporary art market is highly unregulated, not transparent in its pricing strategies and has experienced continued exponential growth. Over the last 20 years we've observed exponential growth in the market. I worry that this situation is in fact a bubble and a crash is imminent. These sales are the typical warning signs of a bubble that are often ignored because in the short term, people are making money. It's difficult to admit that you are going to eventually lose out when you are currently reaping major returns. I see many parallels to the housing market pre-2007. On the surface it seems that a drastic depreciation in art prices would only affect the super rich, who are the primary investors in contemporary art. With so many firms investing in volatile art as collateral, the issue grows larger than just affecting the super rich. If the value of a corporate collection of art works were to suddenly fall, the effect on retired workers pensions is large in scale, yet somewhat unknown in magnitude because it has yet to happen.

I attended the Tribeca Film Festival in 2017 to see a documentary called "Blurred Lines: Inside The Art World". During the directors Q & A I pushed their buttons and asked "when is the bubble going to burst?" and the whole room broke out in laughter. This is the exact same reaction one would have elicited if one questioned the liquidity of the housing market pre-2008.

## 7. Solutions and further research

While there is no single magic bullet to solve issues surrounding art and its financialization, there are small individual actions and large institutional changes that can aid. Below I will enumerate some solutions that I believe can have an impact on the future outlook of the contemporary art market.

Art is largely unregulated. It is not considered part of the investment market as a financial instrument and therefore is not regulated as such. The whole point of having regulation in the financial realm is to protect consumers by creating an open market with transparency of information. I urge you to ask your employer if art is being used as collateral to fund retirement benefits. Having this information can help inform a wiser decision in terms of which type of retirement fund you choose to invest in. Art is unregulated and volatile, two attributes you do not want associated with the financial health of your retirement.

Another piece of knowledge that you should know as a “consumer” of art, is that a significant amount of 21st century art in large museums is “business art”. For example, if you are at MOMA or the Contemporary Wing at The Met, you may be looking at business art that’s being stored by collectors in public spaces to avoid paying capital gains taxes. An awareness of this gives context to the largely white, male artists that are granted display space in large museums.

Finally, forget Art Basel or the Venice Biennial and go to local art festivals and open studios. Invest in local artists. Spending money on art in these spaces is a form of democratizing the art purchasing process. If every person, even of meager means, decided to spend a few dollars on local artists, the cumulative effect would be substantial. I truly believe that the future of art is not necessarily in high priced urban spaces as they have been in the past. The internet brings a sense of interconnectivity to smaller urban communities which are more affordable for low income artists to live and work. Also the internet is a powerful marketplace for artists. In order for these communities to flourish, governmental bodies must invest in cultural assets. Strengthening the market for art in a decentralized way contributes to economic development in significantly.

If the art market was more open and the purchasing process more democratized, I believe we would be celebrating art created by a more diverse range of artists of different cultures, genders and sexualities. Furthermore, cultural capital would be spread more evenly among a range of cities around the United States, instead of only being concentrated in large urban metropolises like New York City and Los Angeles. Art could be the catalyst that begins the unravelling of our current capitalistic paradigm, where wealth is concentrated among only certain locations and individuals. The financialization of art directly competes with the notion that art contributes to both economic and social well being. Further research needs to be done to determine the true impact that the financialization of art has had on material history. Art and money have never been entirely exclusive, but at what point do we recognize that the contemporary art market has created a generation of sellouts?

*Some chapter topics I'd like to include in future versions:* the history of art and money, art forgery and its effect on price, how the arts can thrive in smaller urban communities and satellite cities, how the arts affects a community's economic health

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