Unregulated Art Market

The art market is one of the very few unregulated markets left in the global economy. Despite the lack of regulations, it is one of the oldest and more established trades in the world, and is characterized by very old principles and conventions. Its structure and power circles had not changed much in two hundred years until the last decade saw the advent of technology that transformed the role of each player. While "perfect" competition only exists in economy books and these recent developments represent important strides towards more transparent business, there are still many imperfections that obstruct even "relative" efficiency in the art market.

Initiatives such as the "Art Industry Forum" have addressed the issue of market imperfections by gathering leaders of every sector in the art world. Whereas ideally all the players would join efforts to correct the imperfections, the fact is that such faults allow some participants, such as institutional investors, to prevail in the industry. Therefore, some may have more interest in regulating the market than others. In an unregulated environment, it may well be precisely this characteristic that makes the market so profitable to anyone with some insight on how it operates.

The underlying reason why specific markets are regulated is to establish fairness and transparency in favor of individual transactions. As transparency continues to increase, market players will have more confidence and feel more assured. How then should the art market, which has been operating without a single regulation for centuries, be supervised and controlled to achieve more transparency?

Theoretically, in efficient markets, regulation should come within. This means that demand and supply forces are enough to regulate trade and achieve optimal prices by themselves. However, a necessary condition for efficient markets to work is to have clear and defined *property rights*. Here the first problem arises with respect to art market regulation. In the art market, participants rely heavily on creating relationships of trust on both the demand and supply side, given the inherent risks in an artwork's history, provenance and title.

There is also the question of *territorial scope.* It would be very hard if not impossible to establish and enforce art market regulations through authorities on a global scale. But this sheds light on the possibility that the presence of the knowledgeable, international and private institutional investors -those that initially may be called out for having unfair advantages with respect to the rest- and the participation of more of them as time goes by, could have a very positive impact on regulation in the art market. This is because the development of investing in art as a formal asset class has brought about plenty of academic research and reflections on how to transform the art world into a more economically efficient sector.

It is inevitable that the art market will be affected by the current synergy with the financial sector. As institutional investors continue to implement protocols and guidelines of their own making based on precedents in other asset classes and as demanded by their limited partners, "indirect" regulations must slowly permeate the entire trade. It is to be noted that third-party rating companies in the art market are not viable options because the interests that finance them would be the same entities that would be rated. The latter of course, could also be said of the stock market, where we have seen historically that these conflicts of interest are not uncommon.

It is *reputation* in the end that has become the most important characteristic among players in any market and, given the lack of regulation in the art world, the value of reputation there is even higher. Although reputation can be inspired by trust, it is mostly acquired by repeated transactions and trustworthy assessments. A good reputation facilitates transactions and thus overall market efficiency. Generally speaking, trust is the ability to accept vulnerability before other parties. Economically speaking, it is not a rational behavior and may be explained as a conduct seeking the avoidance of risk. Usually trust and transparency are perfect substitutes; however, when transparency is low, additional trust is sought, and then they become complementary. It is said that a transparent market is an efficient market, which would lead us to argue that added transparency is necessary to transform the art market into a "real industry".

It is precisely the demand for this transparency, particularly by institutional investors, that will lead the regulation of the art market. The existence itself of art investment funds, as institutional players in the art market with formally incorporated investment vehicles, has become a very important factor in the process of transforming such market into a structured industry. In this sense, art investment funds not only currently have a market advantage, but also an innate responsibility towards the market in moving it further towards the direction of clarity and trustworthiness.