The Economics of Art and Auctions: The Case of Coin Collecting

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With the growth of the Internet and the greater use of auction based sites such as Ebay, more investment efforts have turned towards collectibles. Until recently, not much attention has been paid to studying these activities. The recent work in the economics of art and auctions can be useful for better understanding the collection of coins.

The purpose of this paper is to highlight recent research efforts in the area of the Economics of Art in order to suggest that there are opportunities for applying these analytics to various collectibles such as coins.

In a popular personal finance text (in the investments section) several chapters are devoted to financial assets such as stocks, bonds and mutual funds, while a chapter is devoted to "alternative assets" titled "Investing in Real Estate and other Investment Alternatives." Within the chapter about ten (10) pages are devoted to investing in real estate and about six (6) pages are devoted to investing in precious metals, gems and other collectibles (Kapoor, ch.17).

With the losses experienced in the stock market and aside from all of what has been taking place in the Real Estate market, the growth of Internet auction sites such as Ebay has become a basis for looking at collectibles as a potential class of investments. (Lucking-Reuters)

Surprisingly many people engage in the purchase or sale of items that fall under the generic "collectibles." Examples would include: various works of art, stamps, fine wines, old cars, Barbie dolls, comic books, antiques and for the sake of this discussion numismatics – specifically coin collecting.

The collection of coins shares with other collectibles the costs of storage, the volatility of prices and the hazard of fraud. The value of a coin can be decomposed into two parts: the metallic value (gold, silver or alloy content) and then the numismatic (or aesthetic) appeal (Reed).

The precious metal component will reflect the current market valuation for the underlying metallic content. (For example, as this paper is being written, the market price for gold is about $430 per troy ounce and silver is about $7 per troy ounce).

Economics of Art

Recently there have been more efforts in the Economics of Art that will assist our understanding of the numismatic (aesthetic) component of the value of a coin.

We can find writings from economists, philosophers, artists and art critics from earlier times. Writers such as Jevons, Marshall, Rousseau and Smith discuss from different vantage points how to value a work of art (DeMarchi). For Jevons even his use of utility analysis was insufficient because it comes down to the “arbitrary fancy” of a monarch or for Smith the tastes of a wealthy person. For Rousseau, owning a unique piece of art reflects envy and conveys status. Marshall in trying to apply a cost of production theory found prices of art to be “an accident” since we are lacking a theoretical rule that can be applied.

Much of the discussion mentioned refers to paintings. Thinking of Marshall, a more recent starting point (and similar view) can be found in Baumol. (Baumol).

Baumol (and later Mei and Moses) analyze the acquisition of a painting from an investor’s perspective. (Mei and Moses)

Baumol, using “repeat sales” data for paintings sold during the period from 1651 to 1961, shows that the average rate of return is low, (less than a government security) while the dispersion of rates (a measure of risk) is wide. The moral of the story being that if one invests in Art, one should do so for aesthetic pleasure as opposed to financial gain.

Mei and Moses (2002) looking at the resale prices of masterpiece paintings also find low rates of return but argue that there is a diversification benefit as rates of returns for works of art have low correlations with other assets.

Ashenfelter and Graddy (2003) looking at several studies suggest that the empirical results for rates of return may hinge on the selected statistical technique which seems to either be a “Repeat Sale” or “Hedonic” technique.

Studying works of art seems to lend itself to Lancaster’s argument that studying consumer demand entails identifying the characteristics of the desired good(Lancaster). This approach seems to favor using hedonic regression analysis although one of the challenges is to identify the relevant characteristics as well as the appropriate form of the relationship between price and the identified characteristics (Griliches). In studying paintings, Chanel, Gerard-Varet and Ginsburgh provide a discussion of the choice of the statistical technique and argue a preference for the hedonic method.
(Note: Also worth mentioning is the growth of the Internet and the establishment of internet based auction sites. The development of electronic commerce through the Internet has expanded opportunities for participants in collectibles markets (Lucking-Reuters, 2000). Lower costs, greater ease of access and more enjoyment in the market process have this phenomenon formidable. With the greater use of Internet auctions comes also greater research interest in such topics as auction theory (Bajari and Hortacsu, 2004).)

<u>Coin Collecting Studies</u>

While there have been several studies in the economics of Art, studies in collectables such as coins have not been as many. Kane (1984) using the CAPM argues that coins can serve both as hedge against inflation as well as have portfolio diversification benefits.

Dickie, Delorme, and Humphreys (2001) using a specified hedonic model discussed how coins were different than paintings in the sense they are often not as unique and there are many transactions where prices seem to more consistently reflect various coin characteristics.

Koford and Tschoegl (1998) develop a model for examining the value of a coin in relation to its rarity. The notion being that the uniqueness of the coin fosters a form of “luxury consumption.” The authors suggest that the exclusivity of owning the particular rare coin underlies its demand. That is the demand is not independent of the supply. The authors further discuss what would seem the special characteristics of rarity.

A Few Concluding Comments

Works of art have special characteristics. Studies seem to suggest that from an investment criterion, a commensurate rate of return given the risk would not alone warrant the possession of a typical aesthetic item. Often it serves as a metaphor for conveying social status, wealth or some unique position.

With the growing body of research in the Economics of Art and the growth of Internet auction sites, one would expect to find increased discussion within Economics and Finance courses.

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