LAST WORD

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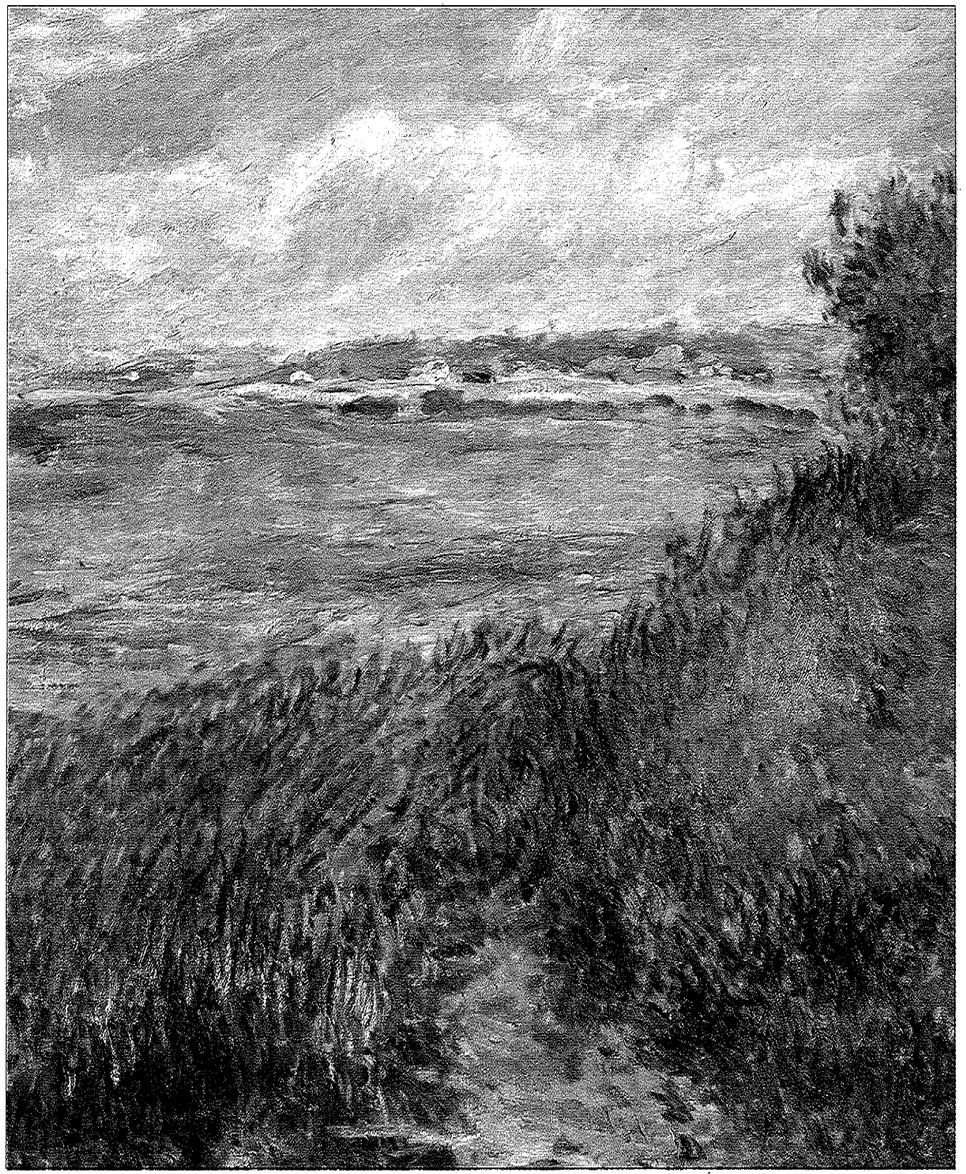

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A cost-benefit analysis

Chrystia Freeland
THE A-TRAIN

Last year's charity auction to benefit the Robin Hood Foundation for poor boys and girls became an emblem of American plutocracy when Tom Wolfe chronicled the extravaganza in Portfolio, the Condé Nast business glossy launched this month to report on the new gilded age. Wolfe described the foundation as being "heavy, heavy, heavily supported" by hedge fund managers, and breathlessly tallied the evening's total take at "an astounding $48m". This year's Robin Hood auction, held a few weeks ago, raised $71m, according to The New York Times.

You don't have to be Paul Tudor Jones II, the hedge fund manager who founded Robin Hood (earnings in 2006, according to Alpha magazine: $690m), to find yourself at a charity auction wondering how much to bid. There can't be many schools in Manhattan – or in many other parts of America – that don't expect parents to pony up for prize-spiced fundraisers, ranging from humble raffles to fully-fledged live auctions, many conducted by professional auctioneers moonlighting for charity.

The hyper-competitiveness of US capitalism and the inventiveness of US technology have made auctions an increasingly familiar feature of national life. Every mom and pop has bought something on Ebay, and bidding wars between private equity tycoons for huge assets, be it Chrysler or Equity Office Properties, are the dominant business narrative of the moment.

But charity auctions are different. They bring together not just money and the competitive instinct – the two most powerful drivers of the plutonomy – but also mix in altruism and peer pressure. The successful charity auction calls on both our vanity and our charity, our greed and our selflessness. These are not always comfortable combinations, but get them right and you can raise an awful lot of money.

Jamie Niven, the vice chairman of Sotheby's who has acted as auctioneer at the Robin Hood gala for the past eight years, says charity auctions are "infinitely harder" than ordinary, for-profit ones: "You have people who don't need to buy something, who are having dinner and drinks ...You have to cajole, you have to entertain, to get them to participate."

He has conducted 31 charity auctions over the past year, but says Robin Hood is in a different league from every other benefit in America. For people in hedge funds and private equity, he says, participation has become a way "to show that you are a player". Even at this exalted level, it usually comes down to the human dynamic that auctions are ultimately about: "You've got to get a competition going. By the time you get to a couple of hundred thousand dollars, it usually narrows down to just two or three people."

> Charity auctions mix altruism with peer pressure – they call on both our greed and our selflessness

Auction theory is a rich branch of economics. Now the dismal science is paying increasing attention to the ways auctions change when the beneficiary is a good cause. Some interesting research is being done at Middlebury College, Vermont, by Jeffrey Carpenter, Jessica Holmes and Peter Hans Matthews, whose work will soon be published in the Economic Journal.

They are looking into the ways in which incentives specific to charity auctions can be used to shape auction design. Many charity auctions, for example, are held to benefit causes that offer direct benefits to most of the participants, whether they win a prize or not – my daughters' schools fall into this category, as do the Vermont pre-schools where the Middlebury *troika* have conducted field research.

At fundraisers like these where even losers benefit, a classic live auction may, Professor Matthews explains, lead to a "curious incentive – bid suppression". We may hold off on making what would be a winning bid because we are happy to see our peers contribute to our shared charity. To avoid bid suppression, the Middlebury economists are investigating "all-pay auctions", in which all bidders pay, usually through sealed bids, but only the highest bidder gets the prize.

Alas, it may be that even in our own communities we are motivated more by personal booty and less by contributing to the greater good than we might wish. The Middlebury team found that while all-pay auctions can be the most effective way of raising money for a one-off event, they have a built-in risk. Bidders, many of whom will pay but not win, may feel disappointed and not come back the next year.

My favourite idea from the Middlebury economists is one they are testing in the lab, but have not yet unleashed on the real world. They call it a "bucket auction" – a bidding 'bucket' is passed around a group of people, each of whom must make a contribution to continue "playing". The winner is the last person to make a contribution. The hope, Prof Carpenter explains, is "to capture both the competitive element and also the feelings we have about sunk costs" – which is to say our often irrational reluctance to give up on something once we have invested a lot in it already.

The Middlebury researchers hadn't heard of the Robin Hood Foundation event. But when I described it to them, Prof Matthews said that the assembly of hedge fund and private equity titans sounded like a perfect candidate for a "bucket auction": "Any mechanism that creates horseraces will do well in a group of people that is more competitive than rational".

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