

# Markets for Sports

Robert M. Coen

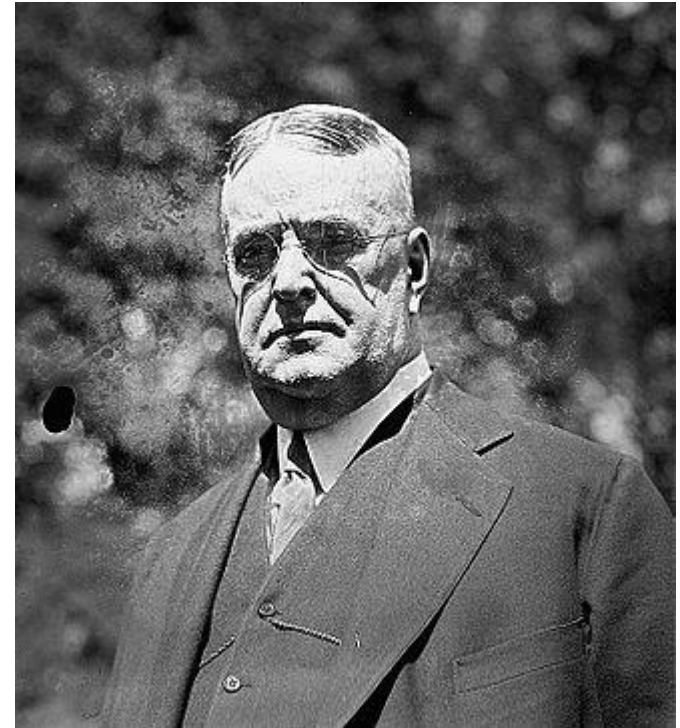
Professor Emeritus of Economics

Northwestern Alumnae Continuing Education

January 26, 2017



William Hurlburt, 1832-1882  
Founded National Baseball League, 1876



Ban Johnson, 1864-1931  
Founded American Baseball League, 1901

# Exemplary Competitive Market

Many small consumers and producers

Competition holds price and profits down, output up

Producers desire to monopolize

Restrict output, raise price, make high profits

Attempts to monopolize thwarted by competition

# What's Different About Sports Markets?

Competition (sporting) is basis of profitability

Nurture competitors, don't destroy them

Product is not just the game

Exciting competition requires economic collusion – a league

Establish rules of game and fair play

Assure competitive balance

Organize crowd-pleasing “championships”

Limit entry to keep prices up, depress wages

Negotiate media coverage

The legal firm is the team; the economic firm is the league

The league is a “natural monopoly”

# Natural Monopoly

Market served most cheaply by one firm

One firm → potentially lowest price for consumers  
Larger firm can drive out smaller

Examples

Railroads

Telephone service (in old days)

Electric and gas utilities

How to control monopoly power? Regulate

Interstate Commerce Commission (1887)

Federal Communications Commission (1934)

Illinois Commerce Commission

# Un-natural Monopoly

Producers collude (cartel or trust) to eliminate competition

## Examples

Standard Oil (1911)

American Tobacco (1911)

AT&T (1982)

How to prevent un-natural monopolization? Prosecute

Sherman Act, 1890

Clayton Act, 1914

# Is Professional Sport a Natural Monopoly?

Many teams can be sustained in a league, but only as cartel

Scale economies arise from “championship” and “media” outputs

Can many leagues be sustained in a market? Probably not

Early professional leagues highly unstable

U.S. baseball and football are examples

# National League History

Preceded by National Association of Professional Baseball Players

Poor scheduling, unstable membership, dominant team

1876 Businessman William Hurlburt forms National League

League faces savage competition -- price cutting, wage increases

1882 American Association

1890 Players League

1901 American League

National League prevails

1903 National and American Leagues form Major League Baseball

1914-15 Federal League comes and goes



# Initial Teams of National League, 1876

Chicago White Stockings (now Chicago Cubs)

Philadelphia Athletics (expelled after 1876)

Boston Red Stockings (now Atlanta Braves)

Hartford Dark Blues (folded after 1877)

Mutual of New York (expelled after 1876)

St. Louis Brown Stockings (folded after 1877)

Cincinnati Red Stockings (expelled after 1880)

Louisville Grays (folded after 1877, players banned for gambling)

# National Football League History

1920 National Football League formed

1940-42 American Football League comes and goes

1946-49 All-American Football Conference comes and goes

AAFC included Cleveland Browns, SF 49ers, Baltimore Colts

1960 American Football League formed

1967 First Super Bowl played

1970 NFL and AFL merge, form NFC and AFC

# Sports Cartel Practices

Roster limits

Reserve clause

Salary caps

Draft priority

Revenue sharing

Promotion and relegation

Seek public subsidies

# Reserve Clause

- 1879 NL owners adopt reserve clause
  - Players cannot change teams without permission
  - Like slavery -- restricts freedom, holds down wages
- 1922 Baltimore, of defunct Federal League, sues MLB for monopoly
  - Supremes rule that MLB not subject to antitrust
  - Why? Not interstate commerce!!
- 1951 Congressional hearings find support for reserve clause
  - Justification: Needed for competitive balance
- 1953 Supremes asked to rule specifically on reserve clause
  - Reaffirm antitrust exemption – cite Congressional inaction
- 1972 Players Union backs Curt Flood challenge
  - Supremes again reaffirm exemption
- 1976 Free agency finally won through collective bargaining

# Did Reserve Clause Achieve Competitive Balance?

Shouldn't in theory

Revenue stream generated by player is property  
Under reserve clause, club owns property  
Under free agency, player owns property  
Property will migrate to wherever it is most valued  
Invariant to who owns it

Didn't in fact

Baltimore and Boston dynasties in 1890's  
Dominance of three NYC teams in 20th c.  
Supremacy of Cardinals 1920-1950  
Poor performance of Cubs, Red Sox, Indians

# Salary Caps

NBA union accepts in 1984-85

Limits player budgets to 53% of average revenue

Benefits owners, penalizes big stars

1995, M. Jordan and P. Ewing seek to decertify union

Caps not effective -- too many exemptions, bonuses

NFL – player budgets limited to 63% of average revenue

MLB has no caps, but luxury tax on excessive player budgets

# What's Happened to Salaries?

Prior to 1976, MLB salaries far below estimates of worth to clubs

After 1976 (with free agency), salaries rapidly rise toward worth

“Free” agency established three tiers

- Rookies, no power

- 4-6 yrs., eligible for arbitration

- >6, free agency

Salaries closer to worth as players move to higher tiers

Average MLB salaries exploded after 1980

\$140K in 1953 (today's \$) → \$2.5M today – up 18X

Players' share of revenue up from 20% to 60%

If pie had remained same, average pay would be up just 3X

Growth of pie main source of average salary growth

# Draft Priority

Pioneered by NFL

Sole right awarded to negotiate with new player  
Worst team gets first pick

In 1978, courts held to be unreasonable restraint of trade

Adverse court judgment led owners to bargain with union

Success in maintaining competitive balance

# Revenue Sharing

In NFL, 40 % of gate goes to visiting team

Sharing of broadcast and merchandise income

Art Modell: "We're 26 Republicans who vote Socialist!"



# Promotion and Relegation

Different business model of English soccer leagues

Football (soccer) Association (1863) dominated by amateurs

1888, first pro league

- Designed by amateurs, not business people

- Goal is not profit maximization

  - Limits on profits and their use

- Desire to maximize number of teams

- In England, four tiers

  - Teams move among tiers depending on record

    - Promotion/relegation

    - Strong incentives for team play and investment

- Growing TV revenue threatens amateur influence

# Monopoly and Technical Innovation

Does monopoly retard innovation? -- AT&T example

Technical advances in delivery of games, expansion of market

Revolution in economic-statistical analysis in sports

Bill James and Society for American Baseball Research

See Michael Lewis, *Moneyball*

Story of GM Billy Beane and Oakland As

Beane uses SABRmetrics to build winning team on small budget

Might innovation destroy some sports?

Golf: Improvements in clubs and balls allow longer hits

Courses must expand in size, making game more expensive

See Harry Brown, *Golf Ball*

# Future of Sports Markets

If natural monopolies, should they be regulated?

Attempts to apply Sherman Act misguided

Should there be joint ownership of league?

Make legal firm and economic firm the same

Focus profit maximization on league, rather than club

Joint ownership of facilities

Greater revenue sharing of all receipts

Should entry and mobility be made easier?

Tiered leagues; promotion and relegation

Should sports leagues be non-profit?

Greater use of revenue for amateur sports and recreation

Promote other social goals

**END**