

The Competitive Imbalance in Major League Baseball

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Abstract

This paper aims to identify why Major League Baseball has a competitive imbalance and economic inequality issue and how to fix it. The first section of the paper introduces Major League Baseball and describes the organization, its history, size, market segment, and business model. The paper then proceeds to identify the problem in Major League Baseball and its origins. This is followed by an examination of a few academic sources that give more insight to the origins of the inequality problem and some proposed solutions. Then, an analysis is conducted to explore the problem in depth including its symptoms and origins. Lastly, three potential solutions are proposed with the pros and cons of each, and a preferred solution is identified and how the implementation should be executed.

Major League Baseball

Major League Baseball is a professional baseball organization that holds 30 teams with 15 teams in two leagues, the American and National League. The roster spots on these 30 teams are reserved for the best players in the world.¹ Each team holds 26 active roster spots who are eligible to compete in a game, but also a 40-player roster of players technically under contract.¹ MLB players report to spring training in February to begin a season that can last as late as November. The rigorous season includes 162 games, a few days off, and large travel demands.¹ Most MLB players enter the league by getting drafted in the amateur draft, which is a draft reserved for players from the United States and its territories, and the players typically play for a high school or university before getting drafted.¹ Drafted players must go through the minor leagues before reaching the official MLB roster, and most drafted players never make it to that point. According to Baseball America, who took data from 1981 – 2010, less than 20% of draft picks end up reaching the Major Leagues. Data from 2011 to now was not used because it's too early to judge those drafts. I currently play baseball as a graduate student for Chapman University. Before attending Chapman, I played at University at Albany and have been identified as a draft prospect by 16 out of the 30 MLB teams. I have close personal ties with front office employees of the Baltimore Orioles, Minnesota Twins, Tampa Bay Rays, and Philadelphia Phillies. One day, I hope to work for a front office or sports agency.

Baseball is known as America's pastime. The national league of professional baseball clubs, often known as the National League (NL), was formed in 1876. The American League (AL) was formed in 1901, and in 1903, the first world series was held in 1903. Major League Baseball headquarters is in New York City. Rob Manfred is the commissioner of baseball which is the highest executive position. The New York City location directs all business and

operational functions of the commissioner's office, Major League Baseball properties, and MLB.com, which includes baseball operations, communications, marketing, technology, economics, development, human resources, and much more.² According to Statista, the overall revenue of the league was at 3.66 billion U.S dollars in 2020.³

Major League Baseball's business model is unique. MLB teams create revenue through television deals, ticket sales, concessions, licensing agreements, sponsorships, and revenue sharing. Revenue sharing is a system where each team contributes a percentage of its local revenue into a pool that gets divided equally in attempt to improve competition.⁴ The goal of this is to keep the less wealthy teams on an even competitive level with the wealthier teams. Baseball is also the only sport that does not implement a salary cap for each team, meaning a team can spend as much money on their players as they like. Another thing that makes Major League Baseball is unique is they have antitrust immunity. No other sports organization is exempt from antitrust prosecution, which means MLB and clubs are free to exploit monopolistic power.

Economic Inequality

It's evident there is a competitive imbalance between Major League Baseball clubs. Teams with more money, more revenue, and a bigger market can spend more than teams who are less fortunate. Teams with more money can acquire better players, therefore giving them a competitive advantage. The New York Yankees have had either the highest, or second highest payroll from 2000 – 2017, meaning they spend the most money on their players.¹¹ Why are the Yankees allowed to spend more money on their players every year? This high payroll has clearly paid dividends on the field to the Yankees, who have 27 world series championships. Entertainment in sports is mostly driven by the uncertainty of outcomes. The structure of Major

League Baseball presents a clear disadvantage to smaller market teams. This paper will aim to solve the problem, ‘How can we achieve economic equality among Major League Baseball teams?’ The paper will identify the why Major League Baseball differs from other professional leagues that have equal opportunity and propose different solutions such as revenue sharing, team salary cap, and the effects of the solutions.

Literature Review

This section summarizes a few academic sources that give a better understanding of the problem in Major League Baseball and allow us to understand the context, origins, and symptoms in depth.

Antitrust Immunity. For nearly a century, Major League Baseball has enjoyed immunity from antitrust prosecution, meaning MLB clubs are able to exploit monopolistic power.⁵ There have been calls to repeal MLB’s antitrust exemption and examination of the issues and policy recommendations as well as arguments that the exemption is beneficial for baseball. Robert D Blair and Wenche Wang explore the impact of monopoly on both income distribution and allocative efficiency.⁵ The legal foundation for MLB’s exemption comes from the unmet requirements that trade or commerce must involve “trade or commerce” and that trade or commerce must be “interstate”. Blair and Wang walk through numerous federal antitrust suits that have resulted from MLB conduct, such as a discussion of *City of San Jose v. Office of Commissioner of Major League Baseball*, which deals with restraints on the relocation of MLB franchises. Then, attention is turned towards *Miranda v. Selig*, which involved a wage-fixing agreement for minor league ballplayers, and *Wyckoff v Office of Commissioner of Baseball*, which involves a no-poaching agreement for baseball scouts. Based on their discussion, Blair and Wang

conclude that all previous challenges to the exemption act have failed due to the vitality of the *Federal Baseball* exemption.⁵ Blair and Wang argue that the original rationale that MLB is not “interstate” in character is false, and the supreme court should revisit the topic of the unwarranted exemption of baseball and the “special treatment should end”.⁵

Others, such as Michael K Hobbs in his academic journal ‘Lifting the Antitrust Exemption Presents a Major Problem for Minor League Baseball’ show there are several reasons the exemption is beneficial. Hobbs comments that should congress lift the antitrust exemption, Minor League Baseball would end due to financial issues that would be created for Minor League Baseball Organizations and cities that hold Minor League Baseball teams.⁶ He points to other cases such as *United state v. International Boxing Club of New York* which an antitrust suit arose when promoters attempted to create a monopoly on the promotion of professional boxing by advertising nationally.⁶ The court ruled that the antitrust exemption given to Major League Baseball did not act as a precedent and meant that all future antitrust claims around other professional sports leagues would be conducted just as any other business antitrust claim.⁶ Hobbs argues that because of the exemption, players, coaches, umpires, equipment, and anything else used to perform a game is paid for by MLB, which lifts a huge burden for Minor League organizations. Hobbs also states that the affiliation with MLB benefits Minor League Baseball by attracting fans when MLB players go on rehabilitation assignments. Rehabilitation assignments occur when a player goes on the disabled list by his team and needs time in the Minor Leagues to make sure he is fully recovered.⁶

The Effect of a Repeal on Team Relocation. In 1980, Oakland Raiders owner Al Davis wanted to move his franchise to Los Angeles, and the NFL blocked him. Davis sued the NFL for antitrust grounds and won the case. The MLB is protected from this rule which enables the MLB

to control the relocation of baseball franchises from one city to another. Thomas R. Hurst and Jeffrey M. McFarland talk about the effect of a repeal of the baseball antitrust exemption on franchise relocations.⁷ The article goes over the history of the antitrust exemption, then proceeds to examine judicial treatment of horizontal market restraints under the Sherman Act involving sports other than baseball which do not enjoy antitrust exemption. Finally, the article examines baseball's current rules governing franchise relocation and examines whether baseball's current regulatory scheme could withstand judicial scrutiny if baseball's antitrust exemption were lifted. Hurst and McFarland conclude that if baseball exemption is revoked, it might prompt a few baseball franchises to attempt a relocation.

Reflection on Salary Shares and Salary Caps. Andrew Zimbalist takes a closer look at the salary and revenue figures for the four major professional sports in the United States. He talks about the issues about properly measuring the players revenues and salary shares and the different ways revenues can be measured. Zimbalist explains the revenue sharing system introduced back in 1996 and how the higher a team's revenue, the more it had to contribute; the lower the revenue, the more it receives. Zimbalist discussed issues such as underreporting the market value of RSN revenue received and other related party revenues. The article discusses the claims in favor of open labor markets in that higher team revenues lead to higher player salaries, but also explains that this can be achieved in other ways such as a salary cap. In one of his most important discussions, he explains that the revenue sharing system does not promote competitive balance. An example of this is if a team received \$30 million in transfers and \$30 million in sponsorship revenue, a team could lowball payroll and guarantee itself an operating profit at the end of the season.⁸ Several teams adopted this strategy and lowered payroll into the \$14-\$30 million range over the subsequent years.⁸

Revenue sharing and player salaries in Major League Baseball. James Richard Hill and Nicholas A. Jolly talk about the changes made to the revenue sharing agreement in the 2007 MLB Collective Bargaining Agreement and how it influenced player salaries. The results indicated that lowering the marginal tax rate indicated that position players experienced an increase in salary and pitchers saw a small increase in salary. The article highlights how revenue and payroll imbalances between MLB teams have increased and resulted in less competitive balance between teams. The article explains how MLB made a change to the collective bargaining agreement in hopes of incentivizing teams to invest in their players and therefore change salaries. The MLB was compared to the NBA to allow for an understanding as to how different unions trying to reach a compromise can affect salaries. Hill and Jolly point to a study conducted by Fort and Quirk where they conclude the reduction in marginal return to a team's winning percentage decreases the incentive for a team to pay the same salary as before and with a reduction to winning, salaries throughout the league should be lower. This is not the first time someone has claimed that revenue sharing does not incentivize teams to spend money on their players. In 2008, the MLB threatened to take legal action against the Florida Marlins for not spending money on salaries, despite receiving the most from revenue sharing the three previous years.⁹

Why Major League Baseball Players Should Demand a Salary Cap. In an article written by Kimberly B. Taft, she emphasizes the competitive balance problem. She examines two methods to fix the problem such as revenue sharing and salary cap and then goes over the history of the collective bargaining agreement. In 2009, the time of writing this article, she was calling for the players of the MLB to demand a salary cap in the upcoming 2011 collective bargaining agreement. She argues the implementation of revenue sharing will allow the league

to institute a salary cap, and players will benefit in the end. It may seem ironic that a salary cap benefits player, but a salary cap would stabilize all teams rather than depress player salaries.⁹

More competition means more fans for smaller cities, which means more money across the league.⁹ One important thing to note is that she states how economists unanimously agree that competitive balance increases revenue, and that a lack of competitive balance causes fans to lose interest in the game and ultimately cause the sports revenues to decrease.⁹

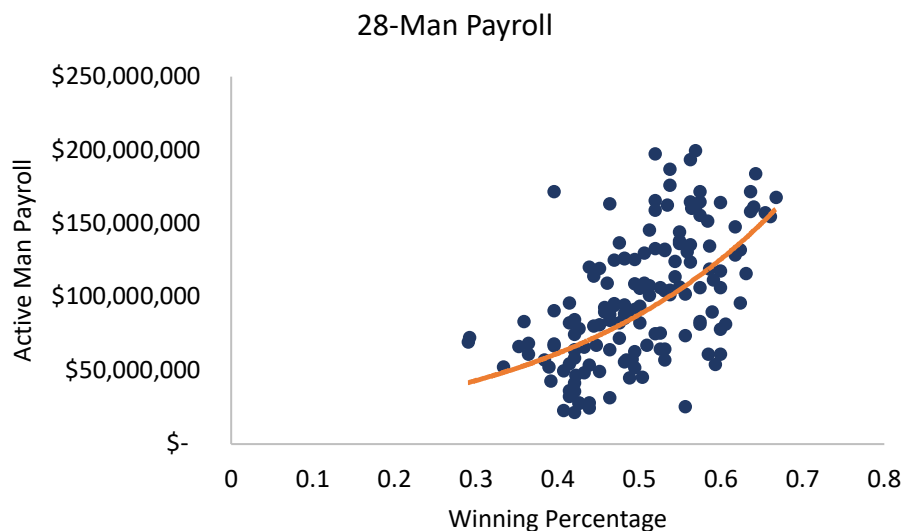
Analysis

Baseball has had a long successful history for over a century with very little changes. The increasing payroll gap between the 30 Major League Baseball team is starting to become a problem as the small market teams have an unfair advantage to the large market teams. Economists have done numerous studies on the extremely strong correlation between competitive balance and fan interest. The logic is not complicated, the more uncertainty there is in the sport, the more exciting it becomes, the more the fan becomes interested, and the more money there is to be made. MLB differs from all the other professional sports in numerous ways such as the antitrust exemption, the lack of the salary cap, and a strong players association.

The competitive imbalance issues come from the huge gap in team payrolls. If teams are allowed to spend more money each year on a consistent basis, such as the Yankees, they can acquire better players, outbargain other small-market teams, and sustain a competitive advantage. However, no one like a team that always wins, and it's why the MLB has been losing interest when compared to other leagues.

Most articles and studies are conducted with data from before the 2011 collective bargaining agreement. There are few recent studies to show if the new collective bargaining agreement has solved the problem of economic inequality. In one of my studies in 2020, I

discovered that team payroll has been highly correlated to team success in the last four years. A sample was taken from the years 2017-2020 using data found from Spotrac.com and Baseball-Reference.com. The variables used were 28-man payroll and regular season winning percentage. As you can see in figure 1, there is a positive correlation between team payroll, meaning teams with a higher winning percentage typically had a higher 28-man payroll.



As you can see, there is an upward trend and a positive correlation that teams that have a higher payroll clearly average a higher winning percentage. This correlation shouldn't serve as a surprise, but teams that make more money are allowed to spend more, win more, and then make even more money from winning. This is causing the gap between large market and small market teams to increase. This causes massive challenges for small market teams and forces a team to build a strategy to field a competing team. This concept is explained more in the book *"Moneyball: The art of Winning an Unfair Game"* by Michael Lewis, where he explains how difficult competing is with a low payroll. In my study, over the past four years the payroll gap has estimated around 160 million. The large market teams like the Red Sox and Yankees

ballparked around 220 million while the small market teams such as the Rays fell just over 60 million.

Many things have led to the large payroll gap that MLB faces today. The antitrust immunity that MLB benefits make it extremely hard to challenge any rules or file a lawsuit against MLB for antitrust purposes. For example, if a team wanted to relocate, they would need to get approval from Major League Baseball, and if MLB says no, there's no way to challenge it. MLB has been against franchise relocation in the past and eliminated teams who failed to generate sufficient revenue. Ex commissioner Bud Selig has stated "It makes no sense for MLB to be in markets that generate insufficient local revenues to justify the investment in the franchise."

Another problem is that due to the structure of the collective bargaining agreement, the players have a right to collective bargaining, self-organization, and the choice of representation, and owners and players need to successfully negotiate each collective bargaining agreement.⁹ The players union have fought the idea of a salary cap due to fears it would result in decreases in their salaries.⁹ In 1994, baseball owners proposed a salary cap to promote competitive balance but to do so by reducing salaries.⁹

Major League Baseball tried fixing this issue when they implemented a revenue sharing system in 1996.⁸ The issue with revenue sharing is that rather than teams sharing revenue, smaller market teams have a better incentive to keep a low payroll so they can operate at a profit. Several teams adopted this strategy, and it preserved the financial strength and stability of the low-revenue clubs, but it did little to produce an incentive to produce a winning team. Therefore, the revenue sharing system that was introduced did little to promote competitive balance.⁸ The other step MLB made was implementing a luxury tax, where if a team's payroll is

over a certain amount, a team must pay a hefty tax. For some large market teams, they still went over the certain amount and decided to take on the tax. It seems like teams would rather have the best players on the field to attract the most revenue and incurring the tax, which is like a parking ticket to them. Despite the holes in the revenue sharing and luxury tax system, there is nothing else that helps promote competitive balance. There is no price floor or certain amount that teams need to spend, and MLBPA has been against it because they think it is a prelude to a salary cap. The MLBPA wants an open labor market, but it is bad for baseball. Teams are allowed to outbid others in free agency, and continue to attract better players, and continue to win more. There needs to be a better solution than a revenue sharing system and a luxury tax.

Solution

In this section I will present three potential solutions for solving the issue of economic inequality and competitive imbalance in Major League Baseball. Each alternative will list the pros and the cons and the steps of implementation. The three potential solutions are a repeal of the antitrust exemption on Major League Baseball, a higher luxury tax with more revenue sharing, and a salary cap. After identifying a solution this section will conclude on what needs to be done, how it should be done, and in what sequence.

Repeal of the antitrust exemption. A repeal of the antitrust exemption would help pave the way for a lot of changes to be made. The strongest benefit of this solution is that it may allow the infrastructure of MLB to change. Allowing the infrastructure to change would let activities change to help promote economic balance among the league. Broadcasting rights and intellectual property, minor league baseball, and relocation of franchises would all be affected if the act is repealed. The current rule allows MLB to wage fix minor league player salaries, denial of franchises to move to larger markets, and pooling of intellectual property rights, all without

the concern of antitrust litigation.¹⁰ The negative of this solution is since the exemption was ruled in 1922, there has been numerous times where people have called for a repeal of the exemption, and either the case does not reach the supreme court or the court rules in favor of MLB. Based off previous court cases, it will be extremely difficult for a repeal of the exemption. Another concern as suggested from Hobbs is that it may lead to the end of minor league baseball. However, in response to MLB moving the 2021 all-star game out of Atlanta, several members from congress are pushing for a bill to be passed removing the exemption.¹⁰ Since this is not a direct solution to the problem, and merely paves the way for the opportunity to fix the inequality issue, in addition to the difficulty to repeal, this is not the best alternative.

More expensive luxury tax with increased revenue sharing. In 1996, baseball introduced revenue sharing to try to combat the payroll gap.⁸ As of right now, MLB salary share is lower than any of the other major professional sports leagues. A higher luxury tax would cause an incentive for teams to try and spend less. If a small market team with lower revenues is receiving more revenue from the larger market teams, they can have more money to spend on their payroll at the cost of the larger market teams.

There are a few issues that arise in this situation. First, a higher luxury tax has proved that it does not stop teams from spending money. The Boston Red Sox recently tried to trade away some of their most valuable players to clear up space and try to pay less tax. The problem is this didn't help small market teams at all, the Red Sox traded former MVP Mookie Betts and former Cy Young award winner David Price to the Los Angeles Dodgers, another team that has one of the highest team payrolls in the MLB. The Dodgers went on to win the world series the next year. The luxury tax does not provide a direct solution to the problem, as we saw that a large market team will simply just shop their players to another large market team. The other

issue that Zimbalist covered was that several teams adopted the strategy of lowering their payroll. This shows that revenue sharing did little to incentivize owners to produce a winning team and achieve competitive and economic balance.⁸ The lower revenue franchises will need to have a price floor that teams will have to spend above on improving their roster to promote owners fielding a winning team. The MLBPA has always maintained that it was in favor of a free labor market and having a payroll price floor would be inconsistent with that as well as fear that it may lead to a price ceiling as well. For those reasons, it is not the best strategy, but it can be combined with another alternative to help fix the holes, and that is a salary cap.

It's time for a salary cap. An effective salary cap combined with the revenue sharing model that Major League Baseball currently has in place will promote economic equality and competitive balance across the league. The advantages for the league are endless. Free agency won't be a bidding war where large market teams will suck up all the best players. There is no market price in baseball during free agency because the large market teams can spend as much as they want on players. For example, in 2008, the Yankees paid the equivalent of the Florida Marlins entire payroll in luxury taxes.⁹ Alex Rodriguez could have used his seasons salary to pay the entire Marlins team and still take home 6 million dollars.⁹ Unfortunately, small market teams are forced to give up their star players. For example, Manny Machado of the Baltimore Orioles went on to sign a 10-year, \$300,000,000 contract with the San Diego Padres. The Orioles could never afford to keep him and field a competitive team, so they were forced to lose him and rebuild again. This diminishes the value of a draft pick. Evan Longoria and David Price were both amazing players for the Tampa Bay Rays. As soon as they became free agents, the Tampa Bay Rays needed to let them go to another team because they didn't have the money to keep them. Fans become discouraged when their star player leaves their team because the

team lacks the ability to pay them.⁹ This will benefit players as well by giving them the freedom to choose any team they want without having to worry about which teams can afford them and which teams can't. Star players are forced out of their franchises because there are hundreds of millions of dollars in other markets.⁹ All in all, a salary cap would allow teams who can't afford "Yankee prices" to retain their star players and boost the value of their draft picks.

The downside to this solution is that with the structure of the collective bargaining agreement, it is going to be difficult for the MLBPA and the owners to come to an agreement. The MLBPA might see a salary cap as limiting player salaries and therefore see it as threatening. Baseball owners proposed a salary cap in 1994 to promote competitive balance by reducing salaries.⁹ The MLBPA fought this in argument that it hurts the players. The biggest difficulty of implementing a salary cap would be to reach a successful negotiation between the players association and the owners.

The reason a salary cap is the best solution is because in the long term, a salary cap would give Major League Baseball the competitive balance and economic inequality to grow their revenues through more viewership. A competitive and balanced league which allow small market teams to grow their revenues as they perform well. Teams with below average payroll have won their divisions less than ten percent of the time over the last 20 years.⁹ Large markets like New York and Boston will bring in revenue no matter if they are good or bad because their market is so large. The Knicks enjoy enormous revenue at Madison Square Garden, and they are never good (except for this year). The overall increase in revenue that comes from the increase in revenue in the smaller market teams will also lead to an increase in players' salaries. That's why the MLBPA should stop fighting the proposal for a salary cap and realize the long-term benefits for players.

Other leagues have seen a ton of success by introducing a hard payroll ceiling and payroll floor. The first thing that will need to occur is an agreement between MLB owners and players and approval of the commissioner, umpire's union, as well as any shareholders in the industry. The league would need 75% of owners and players to vote in favor of a salary cap. The other thing that needs to be discussed is timeline. It would be in the best interest to all the teams and owners if the salary cap and floor would be implemented in a reasonable number of years into the future. This would give owners and teams a reasonable amount of time to prepare for the salary cap and adjust their roster to abide by it. Because the payroll gap is so wide right now, the MLB should implement a salary price and floor that starts wide to give teams time to adjust. Then over time, MLB should tighten the gap to align with a similar proportion in other sports where we've seen success. As the ceiling and floor gap tightens over time and the league achieves economic equality, the league should slowly raise the floor and ceiling together to adjust for inflation and revenue increases.

In conclusion, a salary cap would be great for Major League Baseball and that's why it is the best solution to achieving economic parity. It would increase the incentive to win, it would level the playing field in smaller market teams, which would promote local revenue growth, player salaries to rise, and players happiness to increase due to the freedom of choice in the free agency market. Fans will no longer become discouraged as they watch their team make the playoffs just to lose in the first round. A salary cap has been proven effective in other sports and shown in numerous studies how it can benefit the owners and the players. Hopefully, baseball can implement this change and we can see baseball turn into a beautiful, competitively balanced sport.

Reflection

This assignment influences my personal goals by giving me the opportunity to research an organization that I hope to work underneath one day and discover a real problematic issue. Understanding the history of the organization and the structure of its business is extremely important in solving the underlying issue that we have today. As this academic writing gets improved over time, I have plan on publishing this piece to a sports journal and start to promote the call for a salary cap. This paper has helped aid in my professional development and management leadership by analyzing an organization, taking a summation of research, drawing an analysis, and reaching a conclusion. Seeing the issue all the way from its origins to the problem helped identify a solution. Overall, this assignment provided me with a great deal of knowledge of the structure and current issues with an organization that I'm extremely interested in.

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