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This article explores some of the roots and processes of the contentiousness surrounding baseball labor relations, assesses the new collective bargaining agreement, and examines the history of negotiations that contributed to its structure. The author offers explanations why the 2002 labor agreement is not efficiently structured to achieve its professed goals and argues that the perceived tensions that afflicted the industry in 2002 are not likely to disappear by 2007, when more substantive changes will need to be made in order to avoid another confrontation between labor and management.

Keywords: *major league baseball; labor relations; collective bargaining agreement; revenue sharing; competitive balance; luxury tax*

Mention baseball labor relations to the typical fan and, as sure as Barry Bonds will be walked with a runner on second and two outs, the reaction will be disgust. Some say it is unseemly, if not immoral, for millionaires to fight billionaires in a world riddled with hunger and homelessness. Others personalize the matter and assert that Bud Selig and Don Fehr are both unspeakably despicable, then they state that they will not go to another game until baseball has new leadership.

Of course, if one bothered to ask Don Fehr or Bud Selig what Major League Baseball's (MLB's) labor struggles were all about, one would get sincere proclamations of principle and economic exigency. The players are not really fighting for an extra $100,000 in salary, Fehr might say; they are fighting for principle—the principle of free markets. Players should be paid what they are worth, and there is no fairer test of that than the free market. If the market says Alex Rodriguez is worth $1 million, then so be it. If it says he is worth $25.2 million, then that is okay, too. This principle has served the players well since 1977 and there is little reason for them to abandon it.

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TABLE 1: Baseball Work Stoppages

Year	*Nature*	*Length*[a]	*Regular Season Games Lost*
1972	Strike	14 days	86
1973	Lockout	12 days	0
1976	Lockout	17 days	0
1980	Strike	8 days	0
1981	Strike	50 days	712
1985	Strike	2 days	0
1990	Lockout	32 days	0
1994-95	Strike	232 days	938

a. Length counts both preseason and off-season dates.

The owners, in contrast, have not really articulated a theoretical basis for the case against free markets in team sporting leagues. They simply claim that too many teams are losing too much money and that competitive balance is undermined by free markets. The former argument contains elements of truth but is overstated; the latter is never adequately explained.

It is fundamentally a battle over the degree of freedom in the labor market that has plagued MLB since the mid-1970s. Indeed, each work stoppage since 1976 has been the result of owner efforts to further constrain the operation of free agency and salary arbitration.

As Table 1 indicates, each collective bargaining negotiation since 1972 has been marked by a work stoppage. However, on only three occasions (1972, 1981, and 1994-95) were regular season games lost, and the lockout of 1973 affected only the early-arrival spring training. This, of course, is not to deny that baseball's labor relations have been contentious. They have been. The point, rather, is that sometimes fans (and the commissioner) start to feel sorry for themselves and think they have suffered more than the actual numbers suggest.

This article explores some of the roots and processes of this contentiousness. It then assesses the new collective bargaining agreement. I argue that the 2002 labor agreement is not efficiently structured to achieve its professed goals. Part of the explanation for this deficiency lays in baseball's troubled collective bargaining process in itself.

LABOR RELATIONS PROCESS

Two themes repeat themselves in MLB's collective bargaining history: owners' distrust of owners and players' distrust of owners.

Owners' Distrust of Owners

It has been said that bargaining with baseball's owners is like negotiating with a three-headed monster. In this charming metaphor, the monster's heads represent the high-revenue, the middle-revenue, and the low-revenue teams. Because each group of teams faces a radically different economic reality, each often has radically different ideas about what remedies are needed.

Since 1990, the monster's heads have grown larger and farther apart. In 1989, the revenue spread from the top to the bottom team was approximately $30 million. In 2002—resulting from the explosion of local media contracts and the uneven emergence of new stadiums among other factors—this disparity grew to more than $200 million (Major League Baseball Staff, 2001).

Compounding these reported revenue differentials is the presence of related party transactions (RPTs). RPTs permit a team owner who also owns a related business, such as a local sports channel, to transfer revenue away from the baseball team to the related business or to add costs to the team that originate in the related business. By now, this phenomenon is well known, so I shall cite only one illustration.

According to figures that Bud Selig presented to Congress in December 2001, the Chicago White Sox' income from local TV, radio, and cable was $30.1 million in 2001, and that of the Chicago Cubs was $23.6 million (Major League Baseball Staff, 2001). A curiosity, to say the least. Everyone knows that the Cubs are the more popular team in the Windy City, and TV ratings bear this out: In 2001 the Cubs average ratings were 6.8 on over-the-air broadcasting and 3.8 on cable; the White Sox were 3.6 and 1.9, respectively (McAvoy, 2002). And this does not take account of the fact that the Cubs games are shown on superstation WGN, which reaches more than 55 million homes nationally.

So, what is going on? The Cubs are owned by the Tribune Corporation, which also happens to own WGN. The Tribune Corporation transfers revenue away from the Cubs and correspondingly lowers the costs of WGN. According to *Broadcasting and Cable*, the industry's authoritative source, the Cubs local media earnings were $59 million (McAvoy, 2002). If the Cubs reported this figure instead of $23.6 million, then their reported $1.8 million loss would become a $33.6 million profit in 2001![1] Although the extent of RPTs for the Cubs is unusually large, significant RPTs affect a dozen or more clubs.[2]

Perceptions of baseball's economic reality also differ because franchises have different roles in owners' investment strategies. Often, the team itself is not managed as a profit center but, rather, as a vehicle for promoting the owner's other investments.

Owners can take their investment returns in a number of ways. For instance, George Steinbrenner used his Yankees to create the Yankee Entertainment and Sports (YES) regional sports network in the nation's largest media market. In late 2001, YES had a market value upward of $850 million.[3] Rupert Murdoch recently admitted that his purchase of the Dodgers had already paid off, because it enabled him to prevent Disney from creating a regional sports network in Southern California (Shaikin, 2001). Tom Hicks hopes to use his ownership of the Rangers to develop some 270 acres of commercial and residential real estate around the ballpark in Arlington and to grow his Southwest Sports Group, among other things. Dick Jacobs exploited his ownership of the Indians to promote the value of his downtown Cleveland real estate. To differing degrees, owners exploit their community prominence to establish profitable relationships with politicians and other business executives. Still others derive a handsome consumption return from team ownership.

On top of the growing differences in material circumstance among the owners, owners also diverge in their ideologies and personalities. These differences often produce cliques, and the cliques, in turn, engender rivalries if not animosities. Although fragmentation among the owners was obscured in 2002 by Bud Selig's gag order backed by threat of a $1 million fine, occasional signs of division in the ranks saw the light of day. For instance, one anonymous medium-market club owner told the *Illinois Daily Herald* in late July 2002:

> You think this is funny but this is how Bud operates. He tells 30 owners 30 different things and then slaps a gag order on us and threatens us with a million-dollar fine so that the players don't find out we all hate what's going on. We're supposed to be unified? That's laughable. Lift the gag order again, and you'll see how unified. Now, on top of everything else in Montreal, the [former Expos] minority owners have filed racketeering charges against Bud and [Marlins Managing General Partner] Jeff [Loria], and if the books of every team are exposed during that legal fight, you can say goodbye to Bud and any deal with the players. This is more dangerous than you can imagine. Bud is playing with fire here and we're all getting burned. I'm convinced Bud got his contract extension by threatening 10 of us, making promises to the other 10 and loaning money to the last 10. This thing is on the track headed for a disaster, and Bud is right there in the front of the train conducting the whole operation. (*Sports Business Daily*, 2002a, p. 11)

Alternatively, listen to Selig himself, who, in a moment of public candor, told the Associated Press after the owners voted 29 to 1 to ratify the new labor deal, "I'm not going to suggest to you today that there are not clubs with very different views, but at some point you have to come together" (*Sports Business Daily*, 2002d, p. 13).

At least three problems evolve from this disunity. First, the owners cannot agree on a common vision for the game, let alone a cohesive plan for its future. Their inability to agree on basic demands inevitably leads to long delays before collective bargaining is initiated. Shortly after the owners reopened the 1990 collective bargaining agreement in December 1992, the owners' chief negotiator, Richard Ravitch, told Don Fehr that he wanted to start negotiating right away. Actual bargaining did not begin until March 1994—16 months later.

Selig's unilateral Blue Ribbon Panel produced its report on the state of baseball's economics and its collective bargaining recommendations in July 2000 (Levin, Mitchell, Volcker, & Will, 2000). Then, nearly a year passed before Selig, in the spring of 2001, authorized then MLB COO Paul Beeston to commence discussions with the Players Association (MLBPA). According to Steve Fehr (personal communication, February 20, 2003), a union negotiator, the two sides had 23 meetings between February 28, 2001, and June 20, 2001. When the June 20 meeting adjourned, the MLBPA thought they had an agreement. Beeston had responded favorably to the players' last proposal and said he would get back to them in short order. But the players never heard back. Selig had abruptly terminated the discussions without explanation. The owners did not put their substantive demands on the bargaining table until December 2001—a month after the expiration of the old agreement and 18 months after the Blue Ribbon Panel's report was issued.

A likely explanation for these delays is the disunity among owners. They cannot agree what demands to put on the table, so bargaining is pushed back. Then, when they start preliminary bargaining, a previously dormant ownership clique gets wind of the talks, objects, and the talks are terminated. The end result is that bargaining goes down to the wire and either does not get resolved in time (as in 1994) or is resolved in haste (as in 2002) with a flawed structure resting on compromise.

Second, when the owners finally come to the bargaining table, it is usually based on the lowest common denominator among them: They would like salaries to be lower. Accordingly, rather than producing a coherent, balanced plan for the game's future, the owners' tendency has been to come to the bargaining table with a demand for unilateral sacrifice by the players that restricts free agency rights in one way or another. This sets an adversarial tone to the bargaining process and reinforces the deep-seated distrust that the players have felt toward the owners.

Third, the MLBPA confronts formal ownership demands, but, in practice, it is bargaining with different groups that must be reconciled. It is put in the strange position of triangulating an agreement. This, too, is conducive to inefficient outcomes. For instance, a few owners may find themselves aligning more closely with the players on the issues of revenue sharing and luxury taxes. We know this to be the case at least with George Steinbrenner. As we shall see, this phenomenon leads the majority of owners to seek to penalize owners who break ranks, even if it means deviating from a rational design of collective bargaining institutions.

Players Distrust of Owners

Distrust between players and owners produces its own set of distortions. In his 2002 book, former commissioner Fay Vincent singles out ownership collusion during 1985 to 1987 as a turning point in baseball's labor relations:

> The effects of collusion so thoroughly polluted the whole relationship between the union and the owners that the impact is still being felt. . . . Selig and Reinsdorf, two ringleaders of collusion, were the ones who were the most adamant in saying, "We've got to find some way to get around this union, we have to see if we can break them." (pp. 281, 286)

Collective bargaining in any industry is often characterized by posturing and bluffing. This process in baseball, however, takes on an exaggerated form. Consider, for instance, the maneuvering of Bud Selig during the 2001-02 round of bargaining. In addition to his plan for contraction (which Selig's own Blue Ribbon Panel explicitly stated would not be necessary if its other ideas were implemented), Selig wanted: (a) the owners' 60/40 rule (see below) ratified in the collective bargaining agreement, (b) the establishment of a fund of $100 million that the commissioner could use at his discretion, (c) the right for owners to release players whose salary arbitration figures were deemed to be too high, and (d) a new pension plan contribution system (Zimbalist, 2003, chap. 5). Let us consider the meaning and weight of these bargaining demands.

Selig's demand for contraction was announced on November 6, 2001, 2 days after the end of the old labor agreement and the most scintillating World Series in recent memory. What a way to initiate negotiations on a new agreement! He might as well have launched a grenade at the 12 East 49th street offices of the Players Association. Cutting two teams would mean eliminating 80 union members and reducing the demand for players by 80 as the supply of players stayed the same.

Then Selig announced in late March 2002 that he was going to dust off the long dormant 60/40 rule and begin its implementation during the 2002 season. This rule, first introduced by the owners in December 1982, required teams to maintain a ratio between assets and liabilities of at least 60 to 40. At the time, the players filed a grievance that this rule would affect salaries and, hence, was a mandatory subject for collective bargaining. In his ruling of January 1985, arbitrator Richard Bloch upheld the owners' right to implement the rule unilaterally by arguing that it was a matter of fiscal responsibility and management prerogative.

When Selig announced that the owners would have to comply with the 60/40 rule by June 2002, he stipulated new implementation guidelines. According to press reports and a legal complaint filed by former Mets co-owner Nelson Doubleday, among these guidelines were the franchise valuation rule that a team's value equaled only two times its (trailing) annual revenue and the liability instruction that long-term player contracts would count as debt.[4] Selig threatened noncompliers with fines, loss of payments from the central fund, or being put into trusteeship. On the surface, the implementation of 60/40 smacked of financial prudence, but the reality was otherwise.

Under the liability accounting instruction, long-term player contracts count as debt. This makes no economic sense.[5] As of June 2002 when the rule was to kick in, the Boston Red Sox, for instance, had a remaining obligation to Manny Ramirez of roughly $120 million. For the rest of the squad, the Sox had approximately another $70 million in long-term obligations. So the team's total long-term contract obligations alone were roughly $190 million; that is, they were already $60 million-plus over their debt limit without counting the $40 million of preexisting debt the new owners inherited or the $200 million they had borrowed from Fleet Bank to buy the team. Thus, the Sox would have had to do some massive payroll cutting to avoid violating the 60/40 rule.

Nor are the Red Sox an aberration. According to Selig, at the end of 2001, MLB teams had more than $3 billion in debt, or more than $100 million per team. Using Selig's unreasonably low 2× revenue multiple to value teams and his figure of $112.1 million average team revenues in 2001 (also low because of RPTs), the average franchise would be worth $224.2 million. With an average debt of $100 million-plus (and this is before long-term player contracts), the average team was already in violation of the rule with a 55.4/44.6 asset/debt ratio.

Whatever Bloch may have believed back in 1985, it is clear that the 60/40 rule would function as a backdoor salary cap in 2002. Selig was supposedly implementing the rule in 2002 under the authority of Bloch's ruling. Apparently recognizing its vulnerability, he put it on the bargaining table for labor ratification. The effects of the rule, however, were too draconian to be acceptable to the Players Association.

Why, then, did Selig put it on the table? Is he so out of touch with what is in the realm of possibility? Not likely. More likely, he put it on the table as a bargaining chip to loosen the players' position on other issues. This is part of the bargaining game played by both sides.

The demand for a commissioner's discretionary fund of $100 million (later reduced to $85 million) was only a little more benign. The discretionary fund could have been used by the commissioner to reward teams that towed the commissioner's line. The Players Association believed that this would provide a further drag on salaries. If a substantial fund were needed to help financially distressed franchises, then the players surely wanted it to operate according to set rules or be coadministered much like the Industry Growth Fund from the 1996 accord.

The right for owners to cut loose players who ask for high salary arbitration awards would undermine the value of the longstanding arbitration system to the players. Unless the owners were willing to substitute an equally effective mechanism, such as earlier free agency, it was not conceivable that the players would accept such a change.

The proposal for a new pension plan contribution system called for teams with higher payrolls to put more into the plan. However, players would still receive the same pension benefit. This proposal, in effect, would constitute an indirect tax on high payrolls supplementing the impact of the luxury tax proposal.

Selig, then, loaded the bargaining table with what the players perceived to be harsh, unacceptable demands. None of these demands was incorporated into the final settlement, and there is no direct evidence that they yielded any incremental bargaining leverage for the owners. They did, however, encumber the bargaining process and slow down the already time-pressed negotiations.[6]

I suspect that either side would maintain that the bargaining dance with all its bluster is necessary. And each side would claim that its strategy softened the other. But how many curve balls can you throw an experienced batter before he makes adjustments? It seems more likely that the final outcome has more to do with the relative unity and conviction of each side as well as the underlying economic realities than with the smoke-and-mirrors game of the bargaining process.

THE 2002 OUTCOME

After the ritualistic bargaining histrionics with each side posturing for advantage and resorting to brinkmanship to intimidate the other, on August 16, the players set a strike date of August 30. Negotiations intensified. This time logic and sanity prevailed when a last-minute agreement was reached just in time for the Cardinals to play the Cubs in an afternoon game at Wrigley Field on August 30.

Other than improving the players' benefit fund, raising the minimum salary from $200,000 to $300,000, and introducing drug testing for steroids, the main items in the agreement came from the Blue Ribbon Panel's report (Levin et al. 2000). The report called for three main reforms: increased revenue sharing, reintroducing the luxury tax on high payrolls, and changes in baseball's amateur draft to favor low-revenue clubs.

Increased Revenue Sharing

The Blue Ribbon Panel recommended that the net local revenue tax[7] be increased from 20% under the split pool (see below) to between 40% and 50% under the straight pool (see below). The owners' initial demand was for a 50% tax on a straight-pool system.

The players' resisted such a substantial tax increase. Revenue sharing was being invoked in the name of competitive balance, but the players were concerned that, at such high tax levels, it would also function as a strong deterrent to salary increases. They reasoned something like this. Suppose that George Steinbrenner believes that Jason Giambi will add $20 million a year to the Yankees local revenues. That being the case, he should be willing to offer Giambi a salary up to $20 million. Now suppose that MLB informs Steinbrenner that it will tax away 50% of any local revenue generated by the Yankees. Suddenly, Giambi is no longer worth up to $20 million to Steinbrenner. He is now worth only $10 million and Steinbrenner's offer would be scaled down accordingly.[8]

With this concern in mind, the players countered that they would accept an increase in the net local revenue tax from 20% to 22.5% under the split-pool system (the system prevailing in 2001). Under the split-pool system, of the monies collected from the net local revenue tax, 75% is distributed equally to all teams and 25% is distributed only to teams with below-mean revenues (in proportion to how far they are below the mean.) Under the straight-pool system, 100% of the collected monies are distributed equally to all clubs.

The players favored the split- over the straight-pool system because the split pool, at any given level of total sharing, redistributes more money to the bottom teams and takes less money away from the top teams.

The players wanted more money going to the bottom teams because the bottom teams need it the most, and the pressure for salary controls and additional revenue sharing comes most intensely from the bottom. They wanted proportionately less money taxed away from the high-revenue teams, because they did not want strong penalties on building a successful club. Moreover, it is the high-revenue teams that generally drive the salary structure upward.[9]

We can see the differential redistributive effects by comparing the results of a 25% tax under the split pool with a 40% tax under the straight pool. Each system generates approximately the same amount of total redistribution; using 2001 team revenues, the former shares $204 million and the latter $200 million. According to my estimates, the four bottom-revenue teams in 2001 (Marlins, Royals, Expos, and Twins) would receive $12.6 million more under the split pool, and the four top-revenue teams (Yankees, Seattle, Red Sox, and Mets) would be taxed $26 million less under the split pool (see Zimbalist, 2003, chap. 5).

The owners preferred the straight pool for much the same reasons. They wanted ongoing pressure to increase revenue sharing and retard salary growth. They wanted to penalize the high-spending Yankees as stiffly as possible. Further, more teams experienced larger benefits under the straight-pool system, so it was easier to gather the necessary ownership votes to approve a straight-pool model.

The bargaining began with the sides seemingly far apart—the owners asking for a 50% tax under the straight-pool system and the players offering 22.5% under the split pool. The owners' proposed tax rate was more than twice as high as the players', but the actual amount redistributed under the owners' system was only 34% higher ($250 million in contrast to $184 million under the players' system). As is usually the case in collective bargaining, these proposals were only initial negotiating gambits. If the players were moving in 2.5 percentage-point increments and the owners in 10 percentage-point increments, then at the very next set of proposals (25% under the split pool and 40% under the straight pool), the sides would find a meeting place. It was a foregone conclusion that the revenue-sharing issue would be worked out.

The eventual agreement on revenue sharing provided for a 34% net local-revenue tax rate on a straight-pool basis. Based on team revenues in 2001, this plan would redistribute $175.8 million from the top to the bottom half of teams. This sum would be supplemented by an additional $43.3 million in 2003 to come out of the MLB central fund and an additional $10 million to come from a $333,333 assessment on each team.[10] The $43.3 million from the central fund would increase to $57.7 million in 2004 and to $72.7 million in 2005 and 2006, while the $175.8 million would stay the same (again, based on 2001 revenues), so that the total amount redistributed would rise from $229 million in 2003, to $243 million in 2004, and to $258 million in 2005 and 2006.[11]

The redistribution of the $43.3 million (and subsequent higher amounts) coming from the central fund would be on a split-pool basis. Thus, over the 4 years, on average, just less than 75% of the redistribution would be on a straight-pool basis and just more than 25% on a split-pool basis. With this in mind, we can estimate the combined marginal tax rates that would confront teams at different revenue levels. For 2003, the combined marginal rate faced by the top-revenue teams would rise to approximately .37 from .195 in 2001, whereas that for the bottom teams would stay roughly at .41. However, when the system is fully implemented in 2005, the marginal rate for the top teams will rise to .39 and for the bottom teams it will climb to approximately .47.[12]

The implied marginal tax rates for the Yankees under this combined system would be approximately 39% in 2005; that is, for every additional dollar of net local revenue, 39 cents would be taxed away.[13] This rate is approximately double the marginal rate faced by the Yankees in 2001. Other things equal, it should provide some modest deterrent to Yankee payroll expenditures.[14]

Although the marginal tax rates on the top teams become significant, those on the bottom teams rise even higher—to approximately 47%. This is a matter of concern. Under the former system, the bottom teams faced a marginal rate of just more than 41%; the new rate starts at this level in 2003 but rises to roughly 47% in 2005 and 2006. This means that, if the Kansas City Royals were to lift their payroll by $10 million in 2005 and if the club were to improve and generate an additional, say, $12 million in local revenues, almost half of this would be lost in lower revenue-sharing transfers. The net effect on the Royals from raising their payrolls in this illustration would be –$3.64 million.

Conversely, if the Royals lowered their payroll and performed even worse (aggravating competitive balance), they would be rewarded with an increase in transfers from the revenue-sharing system. For every decrease in revenues of $1, the Royals would see their transfers increase by 47 cents. So, if the decrease in payroll plus the increase in transfers exceeded the decrease in revenues, the Royals' profit-maximizing strategy would be to lower payroll. With such incentives, it is questionable whether baseball's new revenue-sharing system will motivate the low-revenue clubs to improve the talent on their teams.

High-revenue teams tend to outcompete low-revenue teams in the effort to sign marquee free agents, because the expected incremental revenue contribution of the star is usually greater in larger markets or markets with new stadiums. It is also likely that the relationship between revenue and win percentage is nonlinear with fans responding more to an extra win for a team competing for the divisional lead or a wild-card berth than a team without such chances.

Sometimes this imbalance is aggravated by the ability of an owner to use the baseball team to generate revenue for other related businesses such as a regional sports channel. The differential marginal tax rates in MLB's new collective bargaining agreement confer yet an additional advantage on the top-revenue teams that face a lower rate (although the differential is smaller than it was under the 1996-2002 system.)

From a slightly different perspective, consider the situation faced by a low-revenue team owner before and after the revenue-sharing system is implemented.

The owner will offer a player a salary up to the player's expected incremental contribution to team revenues. The fact that the owner receives a revenue-sharing transfer from MLB does not increase the value of a player's incremental contribution. It does the opposite. If the player increases (pretransfer) team revenue, then the team's transfer will decrease and the net revenue contribution of the player will be smaller. Thus, it is not surprising that Tampa Bay Devil Rays owner, Vince Naimoli, when asked whether the increase in transfers under the new system would all go into payroll, "stopped short of committing to spend the additional money on [player] payroll" saying that he 'might instead use some to pay down the team's revolving line of credit' " (*Sports Business Daily*, 2002c, p. 22).

Largely for this reason, the commissioner's Blue Ribbon Panel and the owners themselves in their initial proposal to the Players Association called for a minimum team payroll (Levin et al., 2000). Teams falling below this minimum would be ineligible to receive revenue-sharing transfers. This mechanism was intended to ensure that owners would invest their transfers in improving the talent on their teams rather than pocketing them. The owners' initial proposal put the minimum at $45 million for the 40-man roster including benefits. In 2001 only three teams fell below this threshold, and none of those teams was more than $3 million below it. By 2002, only Tampa Bay and Montreal fell below this level, and neither was more than $1.5 million below it.[15]

The Players Association argued that this minimum payroll threshold was too low and that they opposed payroll minimums because they violated the spirit of a free labor market and were likely to lead to a maximum payroll (Zimbalist, 2003, chap. 5). The claim that this threshold was set too low is understandable if it would have affected only one or two teams. The latter claim is puzzling. Baseball's labor market already contains a variety of restrictions—one of which is a minimum individual salary, which has been in place for several decades and has never led to a maximum individual salary.

There are also possible practical problems with the operation of a minimum payroll if it is set at an effective level. Suppose the level is set at $55 million and a given team is spending $40 million in year 1. To meet the threshold, it may have to hire players it does not really need or pay them excessive salaries. Alternatively, suppose the same team happens to have invested heavily in player development and is currently stocked with a strong group of young players. In year 1, its payroll might be below the threshold, but in years 2 through 4, as its players become arbitration and free-agent eligible, the payroll might rise above the minimum. These and other situations argue for a flexible minimum payroll; for example, the payroll might be defined as a 3-year moving average, and it might be defined to include all player development expenditures—not just expenditures on the major league roster.[16] But the 2002 accord has no minimum payroll at all; nor does it have any other effective incentives for transfer-recipients to spend the money on players.

Of course, the argument that a team receiving the transfer knows best what it needs to spend the money on makes some sense. Resources will be allocated more efficiently if done on a decentralized, market-oriented basis. Minimum payrolls impose a centralized decision and are likely to result in some resource misallocation (although in this case, MLB purportedly seeks a nonmarket outcome of greater parity.)

The problem with this logic, however, is that it fails to address the issue for which the revenue-sharing system was created—competitive balance. The high, marginal tax rates on low-revenue clubs (discussed above), the possibility of a nonlinear relationship between revenue and win percentage, and the consequent disincentives to spend the transfers on player payroll suggest that decentralized decision making will lead to little improvement in the competitive performance of low-revenue clubs. A reasonable compromise might have been to impose a graduated tax on teams whose payrolls fell below a defined minimum. The tax rate would rise as teams fell further below the minimum threshold.[17]

Commissioner Selig defended the absence of a salary minimum this way:

> One of the myths that surrounded all this is that owners haven't invested the money they got in revenue sharing. In the agreement, there is specific language drafted by both the clubs and the [Players Association] that the money must be spent on their franchise and on players, and it's going to be enforced and . . . it's going to be enforced by me. (*Sports Business Daily,* 2002e, p. 8)

Ironically, one of the biggest offenders in the previous revenue-sharing system was Selig's own Milwaukee Brewers. It is unclear exactly what Selig will be enforcing. The revenue transfers will be spent by owners "on their franchise and on players." Spending money on their franchise can include any operating costs (e.g., front office salaries, ballpark enhancements, team promotion) or interest expenses. There is no guarantee here that competitive balance will be improved. Without a specific formula and methodology, how will Selig know how the transfers are being spent?

From the perspective of improving competitive balance, there is better news in the new labor agreement. In addition to the marginal tax rates, the total amount of the tax is also relevant to teams' willingness to spend on players. Owners never know with certainty what a player will contribute to team revenue. At best, they estimate a player's contribution from a probability distribution. Players perform differently from year to year based on a myriad of personal and team factors. Signing expensive players is risky, and high-revenue teams are generally better able to absorb the risk. As more revenue is transferred away from the top teams, they are likely to exhibit more cautious behavior in signing players, and the bottom teams, with augmented revenue, are more likely to accept additional risk.

Under the new system, the Yankees's revenue-sharing burden, which was approximately $28 million in 2001, would rise to $46 million in 2003, $47 million in 2004, and $49 million in both 2005 and 2006. The Mariners would be the second highest payers with their net contribution rising from $17 million in 2001 to $28 million in 2003 and to $29 million in 2005 and 2006. The Yankees contribute almost $20 million more than the second-highest contributor. A severe burden to be sure, but not as onerous as the nearly $90 million the Yankees would have paid in the owners' original proposal. The heavy tax on the Yankees helps to explain why they were the only ownership vote against the new collective bargaining agreement. If the owners wanted to single out Steinbrenner with their new system, they appear to have succeeded.

On the bottom, the Expos (assuming they still exist) continue to be the largest net recipient with their take increasing from approximately $28 million in 2001 to $31 million in 2003, $33 million in 2004, and $35 million in 2005 and 2006. The Twins, still based on 2001 revenues, are the second-largest net recipients with their take rising from roughly $18 million in 2001 to $23 million in 2003, $24 million in 2004, and $26 million in 2005 and 2006. The Marlins follow close behind the Twins as the third-largest beneficiary. Relative to the last agreement, the Expos, Twins, and Marlins each gain only between $2.5 million and $4.3 million in the first 2 years of the agreement with the Expos's increase eventually rising to $7.5 million in 2005 and 2006. This is in contrast with the extra burden on the Yankees of $21.5 million by 2005 and again in 2006 (without including the luxury tax).[18]

It is difficult to imagine that the modest revenue increases at the bottom will engender appreciably different team behavior in the labor market, particularly given the perverse incentives created by the marginal rates. These high marginal rates are compounded by the expectation that team revenue has a nonlinear relationship to team win percentage; that is, more revenue per extra win may be generated when the team is at the top rather than at the bottom of the division.

Consider, for instance, the early evidence on the Kansas City Royals—the fourth-largest net recipient of shared revenue. *USA Today Sports Weekly* cited Royals owner David Glass telling his front office shortly after the agreement that they should be prepared to "slash payroll this winter" (Nightengale, 2002, p. 41).[19] Other reports stated that Glass ordered a $10 million reduction in team payroll for 2003. As I write in late March 2003, the highest paid pitcher on the Royals's staff for 2003 is Jason Grimsley at $2 million with no other pitcher earning a 7-figure salary. Grimsley himself is reportedly on the trading block. Not one starter on the current staff won as many as five games in 2002. At best, one would anticipate that some of the low-revenue teams may make an extra effort to re-sign more of their young talent.[20]

Thus, a very hefty additional burden is experienced by the Yankees with a relatively modest gain at the bottom. There will also be appreciable burdens for the Red Sox, Mets, and Mariners. Red Sox owner John Henry stated in October 2002 that he expected the new agreement to impart a substantial deterrent on payroll spending by the high-revenue teams:

> The Red Sox would have preferred a less onerous structure while still moving a quarter billion dollars per year. Almost 60 percent of the bill for this tidal wave of dollars is

> going to be paid by four teams. That seemed onerous to us. . . . There is no doubt in my mind that the monetary demand for free agents and arbitration-eligible players is going to drop this year. . . . I think this is a real plus for baseball. (*Sports Business Daily*, 2002f, p. 15)

Thus, if the agreement is to have an impact on competitive balance, it is likely to show up via payroll compression at the top rather than payroll elevation at the bottom.

There is an approach to revenue sharing that obviates the incentive problems of the new system. If the revenue-sharing tax were based on *potential* rather than *actual* revenues, incentive issues would disappear. Potential revenues (analogous to the economist's term, *rent*) could be defined by the size and conditions (e.g., stadium age and lease terms) of a team's market. The larger the metropolitan area, other things equal, the larger the potential revenues.

Straightforward econometrics could be used to estimate potential revenues. The procedure is to estimate the relationship between team revenues and win percentage using controls (dummy variables) for each market. Then, using the estimated equation, assume that a team's win percentage is .500, and predict potential revenue for each team when its performance is average. The tax would then be applied to this (average) potential revenue. If a team performed above average, it would still pay the same tax as if it were at .500. That is, there would be no penalty at all—its tax would not go up—for performing well. Conversely, if it performed poorly, its tax would not go down, that is, there would be no incentive to perform poorly as there is in the current system.[21] Weak teams from large markets, such as the Phillies, Tigers, and Blue Jays, would no longer qualify for handouts. The main drawback to such a system from the owners' perspective is that it would provide much less of a drag on salaries than a tax on actual revenues[22], but this could be dealt more directly through a more effective luxury tax.

Another advantage of using potential instead of actual revenue as a basis for sharing is that it would skirt the problem of accounting legerdemain. Through related party transactions and other mechanisms, teams can (legally) manipulate their reported income (see Zimbalist, 2003, chap. 4). The Players Association is unlikely to call for more rigorous controls, because it is in its interest to have teams pay a low-revenue sharing tax.[23] Because higher tax rates increase the incentive to hide revenue, it is likely that—absent new controls—accounting trickery will intensify under the new basic agreement.[24]

Luxury Tax

The sharpest struggle during the 2002 negotiations concerned the luxury tax on excessive team payrolls (Zimbalist, 2003, chap. 5). Even here, however, both sides agreed early on that there would be such a tax and the only issues were the tax rate and the applicable payroll threshold. These realities suggested that a compromise was attainable.

The appeal of a luxury tax is that it functions as a less draconian and more flexible derivative of a payroll cap. A hard cap prevents a team from spending over a certain amount on players. A luxury tax discourages, but still allows, expenditures over a certain level.

Teams not only have vastly different market endowments (population, corporate base, stadium age), but owners have different maximization strategies depending on the relationship between the team and an owner's other assets. These differences were making payroll differentials explode after the mid-1990s leading some owners to insist that a luxury tax be levied in the name of improving competitive balance.

The owners' initial proposal was that the portion of 40-man roster payrolls above $98 million be taxed at a rate of 50%. The players countered that they were philosophically opposed to the tax, but that position soon morphed into one where they would accept an initial threshold of $137.5 million and a tax rate of 15%.

In the 1996 agreement, the two sides had agreed on a luxury tax of 35% for the top five teams in 1997 and 1998 (and 34% in 1999) (Zimbalist, 2003, chap. 5). The tax had no discernible effect on salary growth. Don Fehr argued that the earlier luxury tax was phased out as revenue sharing was phased in. This was crucial because it is the joint impact of the two policies that matters. Because the earlier tax did not have a fixed numerical threshold, it constituted a moving target that was harder for the clubs to anticipate and react to.[25] For each of these reasons, Fehr said that, with the proposed increase in revenue sharing, the players could not abide a substantial luxury tax this time.

Facing resistance, the owners lowered their proposed rates and raised their threshold. The final luxury tax system, which is much closer to the players' position and is less onerous than the 1997-99 system, is depicted in Table 2. The payroll threshold begins at $117 million in 2003 and rises to $136.5 million in 2006. The tax rate increases from 17.5% for first-time offenders, to 30% for second-time consecutive offenders, and to 40% for teams that cross the payroll threshold 3 years in a row. Given the negligible effect of the 1997-99 luxury tax, it is hard to imagine that the new system will provide much of a drag on high-end payrolls.[26]

Nonetheless, some owners may use the tax—low as it is—as a pretext for cutting payrolls. Rangers owner Tom Hicks, for instance, pledged that his team would always be below the threshold. This is precisely the effect that the owners seek. If the tax were to have such a prohibitive impact via a symbolic threshold, then its significance would be the same as a salary cap. It is more likely, however, in the context of the still-enormous revenue disparities, the different owner objective functions, and the structure of the new luxury tax, that the policy will be little more than a nuisance to a few of the highest revenue teams.

Another factor that might diminish the tax's impact is the possibility of payroll manipulation. Straightforward manipulation, such as restructuring contracts to

TABLE 2: Luxury Tax Thresholds and Breach Rates

Year	*Threshold*	*1st Breach*	*2nd Breach*	*3rd Breach*
2003	$117.0 million	17.5%	NA	NA
2004	$120.5 million	22.5%	30.0%	NA
2005	$128.0 million	22.5%	30.0%	40.0%
2006	$136.5 million	no tax	30.0%	40.0%

SOURCE: *Sports Business Daily*, 2002b, p. 8

make salaries jump one year and fall the next to avoid consecutive breaches or employing large signing bonuses, will not work. Signing bonuses will count the same as salary, and salary will be computed as the average annual compensation over the life of the contract. Yet, what is to stop Steinbrenner from transferring $5 million of Bernie Williams's salary to a *personal services* contract with the YES network or Red Sox owner John Henry from signing Jeremy Giambi to a modest baseball salary plus a guaranteed executive or broadcasting job at New England Sports Network after he retires? A similar cap-evading strategy was employed by the National Football League Denver Bronco's owner Pat Bowlen in signing John Elway to his last contract. Instead of paying Elway a higher salary, he offered to sell him a share of the team at a discounted price.

The Yankees will have a strong incentive to use its YES network in creative ways to reduce player payroll. If the team stays at its $175.3 million annual 40-man payroll, it will pay luxury taxes of $9.5 million in 2003 (and a total revenue sharing and luxury tax of $55.3 million) and of $14 million in 2006 (for a total bill of $62.9 million). Of course, the Yankees will also be motivated to shift team revenue to its sports channel—as will the dozen or so other clubs with significant related party transactions.

Two additional provisions regarding the luxury tax are also to the union's liking. First, if the two sides do not agree on a new contract for the 2007 season, the 2003-06 contract remains in effect but without any luxury tax. This provision provides an additional incentive to the owners to bargain constructively for a new deal.[27] Second, if a team does not pay a luxury tax in 2005, it does not pay any tax in 2006 no matter how high its payroll might go in that year. This provision allows a team that was below the threshold in 2005 to load up on payroll in 2006 without penalty.

Other Considerations

The two sides agreed in concept to introduce an international draft, but they could not agree on the details. A joint committee will study implementation with the aim of initiating it in June 2004. The committee will also study other balanceenhancing draft reforms recommended by the Blue Ribbon Panel, such as giving additional draft picks to low-revenue teams, instituting a professional player draft,[28] and allowing the trading or selling of draft picks.[29]

The arbitration system will remain unchanged (Zimbalist, 2003, chap. 5). Significantly, debt limits will be set in line with team earnings before interest, taxes, depreciation, and amortization (EBITDA) with a 3-year grace period rather than the 60/40 system that Selig advocated. Neither long-term player contracts nor deferred compensation will count as debt under the new system. EBITDA is to be measured after revenue sharing. Teams in new ballparks will be allowed a total debt equal to 15× the average EBITDA over the preceding 3 years (after a $25 million debt exclusion). Other clubs will be allowed an EBITDA multiple of 10. This new EBITDA regulation may prove quite controversial. Because most clubs today claim that they have a negative cash flow, this rule may be used as a pretext to severely restrict payroll to meet future debt limits. In contrast to team revenue sharing, with the new EBITDA rule in place for 2006, the MLBPA will now have a direct incentive to monitor each team's accounting to be sure that all revenues and costs are being properly reported. That is, for the first time, the MLBPA will want to oversee the income-statement shuffling that occurs as a result of related party transactions. Disputes over this may be explosive.

Additionally, the two sides agreed that player-deferred compensation must be fully funded within 18 months of the year in which it is earned. Contraction is tabled for 4 years. If the owners decide to contract the league for the 2007 season, the MLBPA agrees not to bring a National Labor Relations Board challenge and not to undertake or encourage an antitrust complaint. However, to contract for 2007, the owners must take a vote between April 1, 2006, and July 1, 2006, and must notify the players of their intent (and provide a 2007 playing schedule) by that latter date. Further, the owners agreed that any effort at contraction will not involve more than two teams and that the Players Association will have full rights to bargain over the effects of contraction.

Selig appears already to be exploiting the MLBPA's concession on contraction. On February 6, 2003, at a San Francisco luncheon, Selig raised the specter of contracting the Oakland As unless the team receives a publicly funded stadium.[30]

As mentioned earlier, the two sides also agreed to improve the players' benefit plan, with the owners' annual contribution increasing from $70 million to $115 million, and to raise the minimum salary from $200,000 to $300,000. Finally, the players agreed to testing for anabolic androgenic steroids through the terms of the agreement.

ASSESSING THE ACCORD

The 2002 agreement is the product of compromise. The owners' original revenue-sharing plan called for the redistribution of $250 million annually under the straight-pool system. The players proposed a redistribution of $184 million under the split pool. The final agreement is considerably closer to the owners' position: roughly $255 million redistributed at full implementation (with lesser amounts in 2003 and 2004) under a system that is a three quarter straight and one quarter split pool (Zimbalist, 2003, chap. 5).

The final compromise on the luxury tax, however, is much closer to the players' position. The threshold rises from $117 million to $136.5 million, and the rates vary from 17.5% to 40% depending on recidivism.

The agreement is likely to produce some modest changes in the desired direction. Over the agreement's 4-year period, close to $1 billion will be shifted from the top to the bottom teams. It will be surprising if this does not level performance outcomes somewhat—mostly by blunting the top rather than lifting the bottom.

Even though the Yankees are hit hardest by the new agreement, the size of their market and their ownership of the YES regional sports channel may make it difficult to blunt Steinbrenner's aggressive acquisition of players. The crossownership of YES and the Yankees opens the possibility for redirecting tens of millions of dollars away from the team and away from MLB's revenue sharing. In January 2003 interviews with MLB.com (January 7) and the *New York Times* (January 8), Steinbrenner commented on baseball's new revenue-sharing plan:

> But we're also going to keep putting money back into the team to do the important things for our fans. *We'll find ways that are legal and proper* [italics added]. . . . Reward your fans. You don't need to put it in your pocket like 90 percent of the rest of the owners may do. I feel we're very heavily loaded with revenue sharing. We're not going against it. *We're trying to figure out ways to go around* [italics added] and still contribute. (*Sports Business Daily*, 2003b, p. 19)

Reinforcing this effect may be the fact that Steinbrenner's initial investment in the team was only $8.5 million 30 years ago. He may feel a bit like a Las Vegas gambler who is playing with house money. This is in distinct contrast to the new Red Sox owners who paid more than $700 million for the team and its assets and assumed several hundred million dollars of debt. Although the marginal perspective would argue that Steinbrenner and Henry should apply the same criteria when contemplating the signing of a free agent, the different psychology generated by an owner's paid-in capital and debt positions is likely to be significant.

As shown in Table 3, at full implementation, the new system places a proportionately larger burden on the top quartile of teams (whose tax share rises from roughly 67% under the old system to 72% under the new one) and provides a proportionately smaller gain to the bottom quartile (whose share of proceeds falls from about 70% to 63%.) The middle two quartiles benefit disproportionately from the new system.

Because MLB will likely generate in excess of $15 billion in revenue during the period of the new collective bargaining agreement, the new revenue-sharing schemes will redistribute less than 7% of the game's resources. Because of this and

TABLE 3: Revenue-Sharing Systems Compared (In Millions)

	Total Redistributed	*1st Quartile*[a]	*2nd Quartile*	*3rd Quartile*	*4th Quartile*
New system (2005)	$253.35[b]	–$182.15	–$71.2	$89.15	$154.2
Shares		71.9%	28.1%	36.6%	63.4%
Old system (2001)	$168.24	–$112.52	–$55.7	$50.37	$117.87
Shares		66.9%	33.1%	29.9%	70.1%

a. The 30 teams are divided into eight teams in each of the top two quartiles (together including the 16 payers) and seven teams in each of the bottom two quartiles (together including the 14 recipients).
b. Total includes $10 million collected from each team for the discretionary fund. Recipients' total is $243.35 million, because it is not yet known how this $10 million will be distributed.

the incentive problems identified earlier, the procompetitive balance effect of revenue sharing is likely to be minor.

Some salary restraint is likely to flow from the new agreement. Marginal revenue-sharing tax rates in the neighborhood of 37% to 47%, along with the luxury tax, will deter salary growth. The new debt rule (connecting allowable debt to team cash flow) to take effect in 2006, along with new financing requirements for deferred salary, should further retard player salaries.

Factors outside the agreement are likely to inhibit salary growth even more. The weak economy along with the stock market's travails and the bleak financial fortunes of several team owners whose other investments have foundered[31] probably provide a more powerful deterrent to salary growth than anything in the new collective bargaining agreement. The widespread introduction of well-educated, business-minded managers into teams' front offices as well as the increased use of statistical analysis to assess player potential may also slow salary growth. New insurance industry policies limiting player coverage to 3 years with higher premiums and additional restrictions is certain to reduce long-term contracts. And, the MLB-imposed $40 million payroll limit on the Montreal Expos for 2003 raised the prospect that several of the team's star players would be available at below-market value thereby moderating the interest in other free agents and further reducing salary offers.[32]

Whatever the combination of factors, it is clear that player salaries took a hit during the 2002-03 off-season. Guaranteed salaries fell by an average $626,141, or 16.5%, for the 65 free agents who had signed major league contracts as of January 8, 2003. Thirty-four of the 65 free agents took pay cuts relative to their previous year's salary. At the same time the previous year, only 14 of 55 free agents had taken pay cuts and average free agent salaries had increased 23.6% (King, 2003).

The industry's finances are more a distributional than an aggregate issue (see Zimbalist, 2003, chap. 4). The new revenue-sharing transfers will help modestly to alleviate this financial imbalance.

The recent successes of the Twins, the As, and the Royals notwithstanding, the correlation between payrolls and on-field success has been too strong to ignore.[33] Although the agreement will contribute mildly toward rectification of the imbalance, the financial trajectory of the industry is likely to contribute even more. Central fund revenues (which are divided equally among the teams)[34], absent a prolongation of the country's economic doldrums, should experience solid growth during the course of the agreement. There is an automatic step-up in the national television money, sponsorship revenues have been soaring, baseball's net Internet income is projected to reach $100 million in the next couple of years, and international revenues have been growing.

At the same time, the low-revenue Padres, Reds, and Phillies will be playing in new stadiums, and there are likely to be new challenges to the ability of cable companies to pass along sports programming costs to consumers, perhaps resulting in lower team local-cable revenues for the high-revenue teams. This tendency is illustrated in the shutting down in November 2002 of Paul Allen's regional sports channel that had been formed to carry the National Basketball Associations's Portland Trailblazers. AT&T Broadband was unwilling to pay the rates (a relatively modest 50 cents per subscriber per month) that Allen sought (*Sports Business Daily*, 2002g). It is also seen in Steinbrenner's difficulty in getting Cablevision to put his YES network on expanded basic at $2 per subscriber per month—although, in this case, the cable distributor (Cablevision) had an additional motivation—and in the January to March 2003 rate disputes between Time Warner Cable, on one hand, and Fox Sports Net North in Minnesota and the Sunshine Network in Florida on the other.[35] Together, these forces are bound to produce some additional leveling in the distribution of club revenues.

Amelioration notwithstanding, it is difficult to imagine that the distributional and financial tensions that are perceived to afflict the industry in 2002 will disappear by 2007. There is little question that the game will need other changes to avoid another labor/management confrontation next time.

NOTES

1. This figure possibly should be adjusted for the superstation payments that the Cubs make to Major League Baseball (MLB), which are probably on the order of $15 million annually. However, it is also likely that the *Broadcasting and Cable* figure is conservative.

2. For more on related party transactions (RPTs) and how they affect other franchises, see Zimbalist, 2003, chapter 4.

3. Goldman Sachs reportedly purchased a 40% stake in the Yankee Entertainment and Sports (YES) Network in 2001 for $340 million. Assuming no minority discount, the Goldman Sachs's acquisition implies an $850 million value for YES.

4. Doubleday's complaint was against his erstwhile Mets partner, Fred Wilpon. According to Doubleday's counterclaim, Selig also included team stadium debt in liabilities where it was not counted in the original 60/40 rule implementation guidelines.

5. When players are paid in future years, they also generate revenue. This type of long-term contract does not accord with traditional notions of debt, save for the special case of uninsured injury. Deferred compensation is a different matter and is discussed below.

6. Arguably, one of the reasons why Selig put the harsh demands on the table was that the owners really wanted the outcome of the Blue Ribbon Panel's recommendations. If they put those recommendations forth as their initial demands, the final outcome would have compromised and vitiated the magnitude of the desired changes. Thus, the owners instead decided to put extreme demands on the table with the hope of compromising to the Blue Ribbon Panel report. Of course, the natural response to such an explanation is that the bargaining *pas de deux* that ensued during 2001 to 2002 was the product of Selig establishing a *unilateral* study commission—one that did not include player representatives. Had they been included, not only could the histrionics have been avoided, but the final outcome could have been more thoughtfully, purposefully, and effectively designed.

7. Net local revenue is all reported local revenue minus stadium expenses. Capital expenses on a facility are depreciated over 10 years.

8. In practice, the Yankees would be entitled to receive back a small share of their revenue-sharing payments. The share would be determined by whether a straight or split pool was in effect. Because of the small redistribution to the Yankees, the net marginal tax rate would be slightly below 50% in this example. This matter is discussed in more detail later.

9. Arguably, an occasional team with strong revenue potential but only average actual revenues will decide to make a drive to the top. The Texas Rangers did this a few years ago with Alex Rodriguez, and the Philadelphia Phillies, in the nation's fourth largest media market and about to enter a new stadium, were being relatively aggressive in the 2002-03 players' market. Thus, one might argue that the straight pool, by giving additional resources to upstart mid-revenue teams, promotes both competitive balance via top team turnover and higher salary thresholds. It seems, however, that this effect is of secondary importance.

10. This $10 million fund can be disposed of at the discretion of the commissioner within certain negotiated guidelines after consultation with the Players Association. It is what remains of the owners' initial proposal to have a commissioner's discretionary fund of $100 million.

11. Although mlb.com reported that the total amount of shared revenue will grow from $258 million in 2005 to $301 million in 2006 (both based on 2001 revenues), the memorandum of understanding executed on October 1, 2002, makes it clear that the system will be at 100% implementation in both 2005 and 2006. Thus, assuming that the level and distribution of revenues is the same as in 2001, the amount of revenue sharing in 2005 and 2006 should be the same.

12. These are estimates based on the level and distribution of 2001 net local revenues. Under the special central fund distributions in the new system, the sums are based on each team's net local revenue over the 3 immediately previous years. So, for instance, the 2004 distributions are based on revenues from 2001 to 2003. Each year the revenue impact is one third, but the yearly revenue enters into the calculation in 3 different years. This necessitates discounting the implied marginal rates. I have used 7% for a discount rate as an approximation to the weighted average cost of capital in MLB. Another complicating factor is that over the 4-year interval, a team may pass from being a net recipient to a net payer or vice versa. My estimates assume that no such jumps occur. Again, more details on the marginal rates can be found in Zimbalist, 2003, chapter 5.

13. The marginal tax rate under the straight pool with a 34% nominal rate is 32.866% for all teams.

14. The Yankees's aggressiveness in the 2002-03 off-season players' market appears to belie this claim. (The team's 40-man roster payroll is projected to rise to $182 million in 2003 from $175 million in 2002.) Absent the higher tax, however, it is probable that the team would have spent still more money. Part of the Yankees's behavior is explained by the team's vertical integration and RPTs. More on this below.

15. For luxury tax purposes, the 40-man payroll uses the average annual salary of players over the length of their contracts. Thus, if a player in 2002 were on the first year of a 4-year deal that paid him $10 million in 2002, $14 million in 2003, $18 million in 2004, and $22 million in 2005, his salary for luxury

tax purposes would be recorded as $16 million in 2002 even though the team was paying him $10 million that year.

16. The typical team spends roughly $14 million per year on player development.

17. This graduated tax would be instead of simply disqualifying all teams that fell below the minimum from receiving any transfers. For example, if a team is below but within 10% of the minimum, it might lose 20% of its revenue transfers; if it is between 10 and 20% below the minimum, it might lose 40%; and so on. A similar graduated system could be applied for the payroll luxury tax. For a related discussion, see Weiler (2000, especially chapter 18). Also see Ross, 2002.

18. Several low-revenue franchise owners had difficulty concealing their euphoria over the new agreement. The Royals, for instance, will see their yearly transfers rise from $16 million in 2001 to $21 million in 2006 (or more as MLB revenues grow, as these estimates are based on 2001 revenues.) Because franchise values in MLB are roughly 2.5 times the trailing revenues, when the Royals receive $21 million in transfers, not only does it greatly help their bottom line, but it will raise its approximate franchise value by 2.5 times $21 million or by $52.5 million. Further, if competitive balance improves as a result of the agreement, one would expect that baseball's popularity will grow and the Royals value will be lifted further. It is the hope for a lifting-all-boats phenomenon that may mollify the opposition of high-revenue owners. Some owners look at the National Football League (NFL) experience, where competitive balance is very developed, to justify their expectations that all franchise values in baseball stand to gain appreciably.

19. The Royals already had the fifth lowest payroll in MLB in 2002.

20. The Phillies, in the nation's fourth largest media market, appear to be embarrassed by their welfare riches. Their revenue-sharing transfers together with their approximately two-thirds publicly funded new stadium appear to have awakened ownership from a prolonged slumber.

21. Using data from 1995 through 2001, I regressed team local revenue on team win percentage, city dummies (leaving out the city whose team had the mean revenue), year dummies (omitting 1995), and a stadium age dummy. The results put the Yankees potential revenue at $64 million above the average, the Orioles $33 million above, the Indians $25 million above, the Red Sox $25 million above, the Braves $18 million above, the Expos $49 million below, the Twins $39 million below, the Pirates $29 million below, and so on. If negotiators deemed the modeling issues to be too problematic, a simpler measure of potential revenue could be employed instead. For instance, in the September 2, 2002, issue of *Business Week*, Michael Mandel (p. 26) developed the concept of a city's *economic base*, which he defined as the total personal income of the city divided by the number of teams. The Yankees and Mets each had an economic base of $418 billion—the average MLB team was in a city with an economic base of approximately $150 billion. Mandel's straight division by the number of teams suggests that two teams split a city's market in half. Econometric work suggests that an additional team in a market reduces the market by closer to 30% than by 50%. An explanation for this is that two teams might intensify the baseball culture in a city and promote interest via rivalry.

22. For this reason and because certain teams like the Phillies, Tigers, Blue Jays, and Angels would be converted from net receivers to net payers, it would be difficult to garner the necessary ownership votes in support of the system.

23. There is an interesting contrast here with the National Basketball Association (NBA) collective bargaining agreement, which spends several pages on the problem of measuring RPTs. The difference is that, in the NBA, salaries are tied explicitly to revenues. It is in the union's interest that these revenues be counted. In MLB, without any payroll cap, it is in the union's interest that these revenues not be counted and, hence, not be taxed.

24. The contributions and marginal rates estimated in the text assume no additional revenue shuffling by the teams.

25. Of course, the opposite effect might also occur; that is, when owners do not know the precise threshold, they may become more conservative. Although the threshold was not stipulated in years 2 and 3, under most circumstances, it was calculable after the threshold in year 1 was defined.

26. The proceeds from the luxury tax will be spent as follows: 50% to the players' benefit plan, 25% to the Industry Growth Fund, and 25% to develop players in countries that do not play organized high school baseball and/or are being added to the first-year player draft.

27. The NFL has included uncapped payroll in the final years of their collective bargaining agreements to provide a similar incentive. Some believe that it is partly for this reason that the NFL owners have always been anxious to extend the old contract 2 or more years before it expires.

28. A variation on the theme would be to restructure the Rule 5 draft. Instead of letting teams protect 40 players from the annual Rule 5 draft, they might be allowed to protect only the 25 players on the active roster plus an additional five to eight designated top prospects for a 2-year period. Such a modification would prevent top teams from stockpiling good players.

29. Interestingly, after the Yankees won their fourth consecutive World Series in 1939, the owners of American League clubs passed a rule intended to break the Yankees's victory string. The rule barred each year's pennant winner from buying, selling, or trading any player within the league during the following season. The Tigers edged out the Bronx Bombers for the 1940 pennant and the owners repealed the rule only to see the Yankees storm back with a vengeance to win the next three pennants in a row. Maybe the rule worked! The arbitration system will remain unchanged (see Tofel, 2002).

30. An article in the *San Francisco Chronicle* commented that Selig "wasn't asked a single question about contraction. So he brought it up himself. 'I don't know why I bring it up willingly, but it just shows you I'm a masochist at heart' " (Shea, 2003).

31. The investment firm of Tom Hicks, owner of the Texas Rangers, reportedly lost some $1 billion in telecom and broadband investments in recent years and also invested more than $1 billion to develop a media empire in economic basket case Argentina. Others in trouble include: Larry Dolan of the Indians whose family business, Cablevision, lost more than 90% in stock value during 2001 to 2002; Ted Rogers of the Blue Jays whose company, Rogers Communications, saw its shares lose more than 70% of their value; Jerry McMorris of the Rockies whose trucking company, NationsWay Transport, went bankrupt 2 years ago; John Moores of the Padres whose software company, Peregrine, fell in value from more than $80 a share to below 30 cents a share; Vince Naimoli of the Devil Rays whose company, Harvard Industries, was delisted from Nasdaq, filed for bankruptcy, and tried to terminate Naimoli's $3 million consulting contract; and, of course, AOL/Time Warner, owner of the Braves, whose stock fell from $60 to $13 a share during the 2001-02 season. These owner financial woes are detailed in Walker (2002) and McGraw (2002).

32. In early 2003, the MLB Players Association demanded that MLB turn over documents related to possible central office manipulation of the 2002-03 players' market. This leaves open the question of whether collusion may have contributed to the soft players' market.

33. It is a correlation that, despite the poor performances of the high-paid Mets and Rangers and the superlative performance of the low-paid Twins, continued to be positive and significant at the 1% level in 2002 (based on the 40-man, season-ending payrolls).

34. This applies to all central fund revenues except those retained by the central office and those that are part of the new revenue-sharing scheme.

35. Fox Sports Net North was seeking a 45% rate increase above the existing $1.50 per subscriber per month. Time Warner offered a 10% increase. The Sunshine Network sought a 40% increase above its monthly rate of $1.26. Again, Time Warner offered only 10% (*Sports Business Daily*, 2003a, p. 7). The two RSNs settled with Time Warner on mid-range increases in late March 2003.

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