

## SPORTS PLAYER DRAFTS AND RESERVE SYSTEMS

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When children play team sports they frequently “pick sides” by first identifying team captains who then alternate in selecting players. The purpose is to balance the skills of the teams so that the match is sufficiently even to interest the participants.

### Limitations on the Freedom to Contract in Professional Sports

Professional sports leagues use a similar scheme to allocate players among teams. Under such a scheme the team which finishes last during the prior season has first choice (or a higher probability of receiving the first choice) from newly available players; the team with the second poorest record selects second, and so on until the championship team of the prior season chooses last. Then the process is repeated, with the weakest team getting first choice on the second round, and so on.

Such reverse order draft schemes are sometimes justified by appealing to the importance of competitive team balance among a league’s members. They are effective only if coupled with a restraint which prevents a drafted player from skipping to a team which did not draft him. This complementary scheme usually consists of an agreement among the teams to refrain from employing a player drafted by another team in the league. It is called a “reserve system,” after a clause inserted into baseball contracts in 1887 that once “reserved” to the team the right to unilaterally impose a new contract on a player if the team and formerly contracted player could not reach a mutual agreement for a contract extension. This clause perpetuated a team’s right to a drafted player over the player’s entire career.

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The restriction imposed by the current draft system generally lasts for one year. A player drafted by a team for which he declines to play can reenter the draft after sitting out for a year. The player who elects to do so sacrifices a full year's earnings, which is significant for professional athletes, whose average career is less than a decade.

From time to time two leagues have operated simultaneously in the same sport in which players might participate. Under such circumstances and absent an agreement between the competing leagues, some players might find more than one team seeking their services. Alternatively, teams in different sports might compete for a player's services. Only a handful of players (e.g., Danny Ainge, Bo Jackson, Deion Sanders) are sufficiently skilled in more than one sport, however, that they might choose between the teams which drafted them in each of two different sports. Dave Winfield, for example, was drafted by four teams in three different sports when he graduated from the University of Minnesota. But, for most players the draft and concomitant agreement among teams not to tamper with their rivals' draftees gives a player only one choice: play for the team that drafted him or abandon sport as a livelihood for a year.<sup>1</sup>

## The Effects of Monopsony

A draft and reserve system creates a situation that economists call monopsony. A monopsonist is a single buyer of an input, in this case, the labor services of a player. To maximize profits a monopsonist restricts the amount of jobs offered so that job seekers, out of fear of unemployment, become more willing to accept a lower rate of compensation. No player works for less than he could obtain in his best alternative job. Many, however, earn less of a "bonus" (or economic rent) over and above their minimum acceptable wage because they fear they will be the ones cut from the team.

Public concern about monopsony usually focuses on the exploitive salaries received by the employees. But there is also an important social welfare<sup>2</sup> effect of monopsony, which can be explained in the context of a player labor market. By limiting jobs to elicit restrained

<sup>1</sup>Playing in Canadian football, European basketball, or Japanese baseball leagues is steadily becoming a more attractive alternative than sitting out a year as salaries in foreign leagues grow.

<sup>2</sup>Social welfare is maximized when resources are allocated to their most valuable use. Value is assessed in terms of consumers' willingness to trade their income for goods and services. Costs reflect values that could be created if resources were devoted to their best alternative use. Social welfare is greatest when resources are employed in all those activities which command prices that exceed their costs.

salary demands from players, teams refrain from employing some players who would create economic value (as reflected by fans's willingness and ability to pay to attend the games in which they play) that exceeds the value they can create in their next best occupation. Those marginal potential players then gravitate to their lower valued non-sports employment opportunities.

The discussion of fairness between the firms and their employees is often a peculiar one in this context, where average player compensation now exceeds \$1 million in professional basketball and baseball, and sports teams are owned largely by the men and women who make up *Forbes Magazine's* annual list of the richest 400 Americans.<sup>3</sup> Sports-salary disputes thus hinge on judging which of two millionaires is more deserving of the net economic benefit created by the fact that sporting contests are of much more value to consumers than the next most valuable goods or services that players could create. The contrived scarcity of jobs, on the other hand, seldom makes headlines because it is difficult to see how many teams there would be, what would be their roster size, and who would be employed if there were no draft and reserve system.

### Public Policy toward Contrived Monopsony in Professional Sports

The draft and associated agreement among teams not to contract with players selected by other teams is an issue for antitrust law. Section 1 of the Sherman Antitrust Act prohibits agreements among competitors which restrain trade. Certainly an agreement between Team A and Team B such that if Team A drafts Player X then Team B will not hire Player X fits this proscription.

How, then, are professional player draft schemes maintained? Major League Baseball is exempt from the Sherman Act under the 1922 Supreme Court *Federal Baseball Club* decision,<sup>4</sup> in which the Court determined that baseball did not meet the interstate commerce requirement for practices that can be regulated by the federal government. The Court in that case concluded that baseball is not "commerce," likening it instead to scholarly lectures. The decision has so far withstood the challenge of periodic appeals (e.g., *Flood vs. Kuhn*, 407 U.S. 258 [1971]). Recently, it has once again been under assault in Congress, this time from Senators Howard Metzenbaum of Ohio

<sup>3</sup>At least 24 of the "Forbes 400" wealthiest Americans in 1986 owned a professional sports team (Blitz and Siegfried 1992).

<sup>4</sup>*Federal Baseball Club of Baltimore, Inc. v. National League of Professional Baseball Clubs*, 259 U.S. 200 [1922].

and Connie Mack of Florida; but the reform bill failed to get out of committee in June 1994, and many of its supporters lost in the November 1994 congressional elections. The 1994–95 Major League Baseball Players Association strike continued to keep the issue before Congress, however.

The other significant North American professional team sports, football, basketball, and ice hockey, have avoided Sherman Act prosecution primarily through the labor exemption to the Sherman Act. This exemption relies on collective bargaining with the respective players' unions. In return for the teams freeing veteran players from the shackles of the reserve system, players' unions have agreed to continue a draft for younger players and included provision for it in their union agreement. Professional basketball is now the extreme case, where only the more promising first year (rookie) players are subject to a draft and bound to the team which drafted them (for one year). One can interpret this turn of events as a conspiracy among experienced players and team owners against new players who, of course, are not party to the union negotiations that perpetuate the draft and reserve clause for new players (White 1986).

### The Effects of Player Drafts and Reserve Systems on Competitive Balance

The remainder of this article argues that (1) player draft systems (and their associated agreements against tampering with players drafted by other teams) frequently do not achieve their avowed goal of balancing competition among the teams in the league; (2) this is fortunate, because balanced competition generally would detract from society's well-being; and (3) what player draft systems really do is redistribute wealth and probably help keep some otherwise financially strapped teams in business. This view of the impotence of draft systems for promoting player skill balance across teams is the conventional wisdom among economists (Rottenberg 1956; El-Hodiri and Quirk 1971; Demsetz 1972; Quirk and Fort 1992: chap. 8) but it receives periodic challenge (Daly and Moore 1981, Daly 1992).

There are two reasons why player draft systems do not balance competition as much as owners usually claim. First, for those sports with a large number of players per team (e.g., baseball and football) one good prospective player per year does not make much difference in overall team talent. But that is the difference a draft makes—one good prospective player per year. The team with the poorest record in the prior year chooses first. At the end of the first round of player selection the prior year's champion selects, followed directly by the

second pick of the team with the poorest record. Except for the beginning of the first round, the championship team and the worst team in the league receive consecutive choices. If there is a continuum of player skills and uncertainty about how new players will perform at the professional level, the team picking second among consecutive selectors can easily get the better players. That reduces the advantage of the weaker team to only its first-round selection. In basketball and ice hockey one excellent player sometimes makes a difference, but for football and baseball the advantages given to weaker teams by the draft system work slowly, if at all.

The second reason player draft systems do not balance competition is captured in the well-known Coase Theorem which states that if property rights are well defined and the costs of buying and selling those rights are not prohibitive, resources will eventually gravitate to their most valuable use no matter who is given the rights initially (Coase 1960, Demsetz 1972). If the rights are given to the party that values them the most, no one else will make an offer for those rights that exceeds their value to the initial owner, and no transfer will occur. If, on the other hand, the rights are initially assigned to a team that values them less than does another, an opportunity to trade those rights exists in which both the initial owner and the purchaser can end up better off. Consequently, the rights would be sold to the team that values them most.

Thus, if a highly skilled new player is worth more to, say, the prior year's championship team, located in a large metropolitan area, but is drafted by the weakest team in the league, located in a low-population area, the weak team might be better off selling its rights to acquire the new player to last year's champion. The teams could agree on a price that exceeds the added revenues the weak team would enjoy if it retained the new player, but is less than the added revenues the new player can stimulate in the championship city. The result is that relatively weak teams draft the top new players, and promptly sell them to their more successful rivals. Since the sale is voluntary, both teams must be better off, including the cellar-dweller that continues to lose. This can explain episodes of talented teams selling off players for cash—for example, the 1960s Kansas City Athletics, the 1970s Oakland Athletics, or the 1993 San Diego Padres.

There may be some limits to such player transfers beyond the requirement that property rights to the players' services be well defined, and transactions costs be low. For example, teams in a league presumably will not continue transfers to the point where both lose revenue because league competition gets so lopsided that fans begin to find the games uninteresting and switch their allegiance to opera

or bird-watching. And transfers during a season may create such confusion among fans that interest wanes sufficiently to make “no-transfer” periods profitable. In general, however, because of trades and sales, player drafts do not lead to the level of playing-skill balance that team owners sometimes claim they achieve.<sup>5</sup>

## The Welfare Effects of Balanced Competition

For the sake of social welfare, this failure to balance competition is fortunate. The argument that balanced playing competition is essential to a league’s survival is usually founded on the assumption that consumers value only one characteristic of sporting contests, namely *uncertainty of outcome*. While there is substantial empirical evidence that attendance is higher when evenly balanced teams compete (Knowles, Sherony, and Hauptert 1992), there is also strong evidence that attendance responds to winning, and the response varies by team (Noll 1974, Whitney 1988, Scully 1989, Porter 1992). Consumers are willing and able to pay more for a winning team in some places than in others. Preferences are not identical. For example, on average Canadians may be willing to pay more for a winning ice hockey team than the typical U.S. resident (Noll 1974).

Even if average consumers value winning similarly in all locations, the rewards for winning still will vary by location. An identical propensity of individuals to attend a sporting contest in two cities will result in similar total attendance only if the two cities have a similar population. It is total revenue, not revenue per consumer, that team owners bank, and there will be more ticket revenue for the owner of a winning team in a larger-population city than in a smaller-population city.<sup>6</sup> Even though an imbalance in team-playing skills will reduce the uncertainty of games and thereby the interest in (and attendance at) those games, the greater aggregate willingness to pay for winning by certain teams than for others can mean that the profit-maximizing degree of competitive balance is far from a perfectly even balance. In a simulation model of a professional baseball league, using actual data from Major League Baseball, Joseph Hunt and Kenneth Lewis (1976) discovered that the equilibrium dominance of the most success-

<sup>5</sup>If the draft and a reserve system promote team balance, then the introduction of free agency in baseball in 1976 should have been accompanied by increased competitive team imbalance. The experience in baseball since 1976 reveals exactly the opposite, however. There has been more competitive balance since free agency arrived than during the period of restricted labor markets (Zimbalist 1992: 95–101).

<sup>6</sup>Local media revenues also are likely to vary with population, exacerbating differences in potential revenue from large and small markets.

ful teams in a six-team baseball league had not been achieved even by the dominating New York Yankees of the 1950s and 1960s.

For the sake of economic efficiency, it is fortunate that player draft systems do not achieve the goals they are allegedly set up to achieve—competitive balance. Imbalance leads to more winning in those places where people get more satisfaction from winning, and less winning where people in aggregate do not care as much about it.

### The Real Purpose of Labor-Market Restrictions in Professional Sports

If player drafts do not achieve competitive balance, and if competitive balance would reduce both teams' profits and social welfare in any case, why then do leagues maintain such an interest in player draft and reserve systems? The answer, perhaps, lies in the wealth-distribution effects of a player draft (White 1986; Quirk and Fort 1992: 235-39). A draft places certain players (namely rookies) in a weaker bargaining position than they would otherwise enjoy.<sup>7</sup> This means that those players subject to the draft will be paid less than they would otherwise earn in an open market.<sup>8</sup>

There is empirical support for this proposition. Prior to the 1970s players largely were bound to the original team that drafted them (or another to which the original team had transferred their rights) for life. When unions formed in the various sports, and collective bargaining began, veteran players in all of the leagues negotiated some relief from this restriction. Professional ice hockey and football players enjoyed the least freedom to negotiate with other teams (until 1993 for football). Baseball players are freed completely from the reserve clause only after six years experience in the major leagues.<sup>9</sup> Basketball players get relief from monopsony exploitation after just one year in the National Basketball Association. Statistical studies of salaries show convincingly that when draft and player-retention schemes are relaxed, large increases in player compensation result (Sommers and Quinton 1982; Raimondo 1983; Hill 1985; Scott, Long, and Scomppi 1985;

<sup>7</sup>New players' bargaining position, particularly for a long-term contract, may remain strong in an absolute sense, however.

<sup>8</sup>Quirk and Fort (1992: 238) conclude that salaries in professional baseball became noticeably less equally distributed as free agency was ushered in after 1976. They find that a disproportionate share of the benefits of free agency accrued to experienced players.

<sup>9</sup>Mandatory arbitration of salary disputes for players with three to five years experience in major league baseball cause some of the effects of free agency to migrate to players with fewer than six years experience because arbitrators can base their decisions on the salaries of comparable players with an additional year of experience vis-à-vis the player in arbitration.

Scully 1989; Kahn 1993; Quirk and Fort 1992). Compensation grew most rapidly at the times the draft and reserve schemes were constrained by either the courts or collective bargaining in each sport, and have grown faster the more relief from the draft and reserve system has been won by the players. Over the past 20 years professional basketball players' salaries have risen fastest, baseball players' second fastest, and football players' slowest (Staudohar 1989). The rapid increase in football player salaries in 1993, the first year of true free agency for veteran players, further corroborates the connection between salary levels and relaxed monopsony restrictions.

The redistribution of wealth resulting from a player draft is not only between team owners and players, and between veterans and rookies. There is also a redistribution of wealth among team owners as those who draft players whose value is greater elsewhere capture some of the differential value through the transfer price. Consequently, generally more successful (winning) teams redistribute wealth to the perennial losers. This helps some financially marginal teams survive, and, unfortunately, means that teams endure in certain cities where fans are not sufficiently interested to pay more than the value of the players' time devoted to some other endeavor including playing that sport in another city.

## Conclusion

The extent to which a player draft and reserve system affects social welfare depends on the ease with which players' contracts can be transferred among teams. The greater the freedom of teams to buy and sell players' contracts, the less damage will be created by a draft and reserve system, and the less damage it will cause to social welfare by shifting winning from places where consumers value it more to places where consumers care less about "being number 1."

If player contracts cannot be transferred easily, then labor market restrictions that convey monopsony power on teams will favor consumers' preferences for uncertain outcomes of contests to the exclusion of differences among consumers in preferences for winning. Consumer welfare is likely to suffer because the efficient balance between winning and contest uncertainty will be missed. If, on the other hand, player contracts can be transferred easily among teams, then the effects on social welfare of a draft and reserve system are innocuous. Under such circumstances, the primary effects of monopsony power in professional sports are on the distribution of wealth among teams, between team owners and players, and among the players themselves.

Social welfare could also be improved on the playgrounds of America if, after choosing sides for a "pick-up" game based on a mechanism

designed to balance team strength, those players who value winning more could pay off those who value winning less for the right to rearrange the teams more to the satisfaction of those who think winning is the only thing.

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