# THE EFFECTS OF SALARY CAPS IN PROFESSIONAL SPORTS ON SOCIETY

**"Lazy Eights"**

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# ABSTRACT

This paper provides an alternative method to the standard salary caps in most professional sports in the United States. It shows how a performance-based salary cap would be the most efficient and effective method of compensation for the athletes. The paper looks at the positives and negatives of the effects on salary caps in the National Football League, National Hockey League, Major League Soccer, National Basketball Association, and Major League Baseball. After reviewing all the possible options, a performance-based salary cap would be the best choice because it provides a competitive atmosphere for each individual professional sport.

# INTRODUCTION

In the United States, salaries in professional sports are very high, and they are continually increasing. To deal with this predicament, sports teams are trying to find ways to satisfy the needs of their players, while at the same time being a profitable organization. Among the five major American sports, there is a fluctuation in their attempts to limit the amount of spending while increasing competitive balance.

The five major sports discussed are the teams in Major League Baseball, the National Football League, the National Basketball Association, the National Hockey League, and Major League Soccer. Each sport has its own unique way of handling its team and players' salaries. These strategies span from a no cap system with luxury taxes, to a fully capped system with monetary penalties. No plan seems to have a perfect solution, as there are major issues with each system.

# Overview of U.S. Professional Sports' Salary Caps

### Major League Baseball

Of the five major sports to be discussed, Major League Baseball is the only sport without a salary cap. Since there is no salary cap, there has been much discussion on whether or not a league without a salary cap is successful. When most people think of Major League Baseball, the New York Yankees and other higher market teams come to mind. People think of these higher market teams because they have the biggest names in the game, are the most marketable teams, and have typically been the best year in and year out. Due to the appeared dominance of the powerful teams, many people want more parity in baseball and feel like a salary cap in baseball would be the solution to this problem.

There is no question that there is an apparent gap in the different team's salaries. According to 2009 Team Payrolls from CBSSPORTS.COM, the Yankees currently have the largest payroll in Major League Baseball. Their payroll, which is $201,449,289, is nearly five and a half times more than the Florida Marlins' payroll of $36,814,000. Alex Rodriguez, third baseman for the New York Yankees, made $33,000,000 in the 2009 season (CBSSPORTS). When compared to the Florida Marlins, Rodriguez would make up almost 90% of the Marlins' salary. Despite the fact of the disparity in salaries among teams, there appears to be no direct correlation between salary and winning percentage. For example, the New York Mets had the second highest payroll in the 2009 season, but only produced a 70-92 final record. Another example, the Minnesota Twins, had the 24th lowest payroll, but won the AL Central. Having a high salary does not always ensure a team's success. However, being able to spend more money allows teams to acquire the players who appear to be the best. Teams cannot predict if a player will get hurt or if they will never turn out. Therefore, there are times where a team may spend an exceptional amount of money and no produce substantial results.

Major League Baseball has created a system to help regulate the teams' salaries and keep them closer in value. Instead of a salary cap, Major League Baseball has implemented a luxury tax. A luxury tax is an arrangement by which teams whose aggregate payroll exceeds a certain figure (determined annually) are taxed on the excess amount. The tax is paid to the league directly by the team that exceeds the annual figure (Salary Cap). The MLB then puts the money into its industry-growth fund. Unlike the NBA, which disperses the luxury tax to smaller market teams, the MLB uses the revenue for other purposes. They use this money to help promote baseball worldwide and also use it for player benefits. (World Series Champs Pay Hefty Luxury Tax).

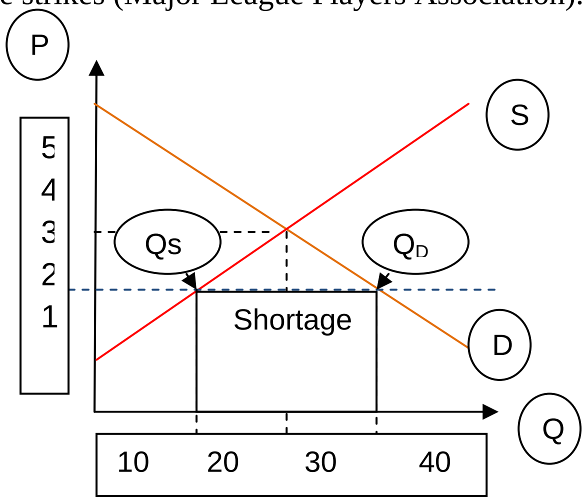
There are harsh punishments for a team that does not stay under the luxury cap system. There is a 17.5% tax rate on the amount the team goes over the first time. The rate then rises to 30% for second-time offenders. Teams that exceed the limit three times of more have to pay a 40% penalty (Salary Cap). The cap limits have increased at a steady rate due to the demand of money from athletes continues to grow. In 2009, the cap was $162 million. The cap is expected to rise to $178 for the 2010 season (Salary Cap).

Following their 2009 World Series Championship, the New York Yankees were assessed with a hefty luxury tax of 25.69 million dollars as a result of all their spending. Over 92% of the tax payments have come from the Yankees since 2003. There have only been eleven occasions where the luxury tax has been enforced. The Yankees have made up for six of these eleven incidents (World Series Champs Pay Hefty Luxury Tax).

While some teams are satisfied with the current cap system, some teams, which include the Milwaukee Brewers, are in favor of introducing a salary cap in the MLB. However, despite their request, many ideas have been turned down by the powerful MLB players' union and the Yankees ownership group. These groups have even threatened to take legal action on teams who support the introduction or idea of a salary cap (Salary Cap).

Experts have used a system to help see how efficient teams are with their money. They assume that a mediocre team would win only 30 percent of their games so they use this as the base. For salary, they set every players at the league minimum, which for 2009 was $400,000 . And finally, they make the roster 25, plus 3 replacement players to allow for the DL. The formula works as such: (club payroll - (28 x major league minimum) / ((winning percentage - .300) x 162). The lower the cost per marginal win that is derived out of this formula, the more efficient the team is. Teams strive to get their cost per marginal win low, which in turn means they are spending less per win. The spreadsheet and graphs at the end of the report show how the teams in the MLB performed during the 2009 season (Brown).

Even though most skeptics believe issuing a salary cap in MLB would be the solution, this is the not the best option. By issuing a salary cap, an overall inefficiency in Major League Baseball could result. This inefficiency could result if the equilibrium price is above the set cap level. "The equilibrium price is established where the overall demand curve for Major League Baseball players salaries meets the curve overall supply" (Modon). Since teams cannot possibly supply the amount that players demand, there would be a shortage of players, which is shown by the graph. Oftentimes, a strike will result from this inefficiency. Throughout the tenure of the MLB, there have been five strikes (Major League Players Association).




There is no question that something needs to be done with the current salary situation in major league baseball. A salary cap might appear to be a suggestive method to for the MLB. However, implementing a salary cap will not eliminate the gap between rich and poor teams. A salary cap will not allow small-market teams like the Florida Marlins to grow. Teams like the Marlins will instead get poorer than they already are. Since there is already such a large cap between the rich and poor, it would be nearly impossible to start a salary cap lower than the luxury tax. There would have to be a realignment of the entire league and teams if a salary cap was implemented in Major League Baseball. Until then, the best case scenario is to let the salary situation play out and not interfere. There will always be a dilemma of the rich teams getting richer and the poor teams getting poorer. Therefore, until then, the Major League's most efficient method would be to let the league govern itself and see how it plays out.

## National Football League

In 1994 the players association and the owners association agreed upon the first salary cap in the sport of professional football. They implemented this change, among other things, to stop the player’s salaries from growing at an exponential rate. This cap in the NFL prevents teams from essentially having an all-star caliber player at every position. For example, the salary cap in the year 2009 was set at $127 million per team. Every team must have 57 players, which means that the average salary per team is just about $2.3 million. However, if a team has three of the bigger salaries in the league, $12 million each, then that drops the average salary of the rest of the team to under $1.7 million each. Therefore, the cap serves an important role in making the competitive advantage a bit more even between the teams.

There are many other advantages to the salary cap system in the National Football League. One of these is the strategy behind the deals between the franchise and the players. Most contracts are now known as “back-ended.” This, in other words, means that the bulk of the money in a contract is guaranteed in the later years, rather than the earlier years. Consequently, if a team is in a bind monetarily, they can trade a player away to clear up cap room easily by sending away a player on a long contract. Also, the later years in a contract are when the player, if they are good enough, will want a new contract. In addition, if the athlete has not reached the expectations, then they can cut him. These two parts of the strategy are the reasons why a team can sign the big contracts without actually shelling out all of their money.

Finally, there is one more advantage to the salary cap. In the NFL every team has the option for a franchise tag. The franchise tag means that one player on each team will be paid the average salary of the top five players in his position for that year. It is a great deal for the team because they can sign a player to a short term deal. However, the players usually do not want to be tagged. Although they will make a lot of money for the current year, the tag means that they are signed to a short term deal, and they do not receive a signing bonus (Eman, 2008).

Along with the positives that are in a salary cap for the National Football League, there are negatives as well. First of all, the question needs to be raised, if the players are not receiving their full salaries because of the cap, then where is the money going? The answer to that is simple. All of the extra money goes straight to the owners. As economist Andrew Zimbalist who consults player’s unions commented, “An effective salary cap is too Draconian and unreasonable. If you're going to use a cap to drive down player salaries, you're just padding owners' pockets" (Pros, Cons of a Salary Cap, 2004).

A big topic is in the works in the NFL salary cap in 2010. Since there are disagreements with the player’s union and the owner’s association, it looks like next season will be the first time in 16 years without a salary cap imposed on any team. This means that the teams with the biggest pocketbooks will be able to spend considerable amounts of money on any free agent (Moore, 2010). Many people believe that this will have a big impact on all of the franchise’s abilities to go far in the playoffs. Players will receive contracts higher than in the past because teams will not have to worry about spreading their money around for other players.

**National Basketball Association**

The National Basketball Association has a strict salary cap which enforces competitive balance around the league. The cap for the 2009-10 basketball season is $57.7 million (NBA Salary Cap, 2009). This issue of competitive balance of the sport is one of the main factors to the necessity of the salary cap. The salary cap in basketball is about 25 years old. It was implemented in the 1984-85 season in order to level the playing field between teams. (NBA

Salary Cap, 2008). For the same reason as other sports, if the NBA did not have a salary cap, there would be nothing to stop a rich owner to essentially buy the best five players in the world, and put them on the same team. Although this would not guarantee a championship, in all likelihood a team would be in an extremely good spot to win every single game.

Although the salary cap does a decent job at keeping the talent spread throughout the league, the fact that it is a “soft” cap hurts it. A soft cap means that although there is a limit on how much a team can spend for their players, they can still go over if they pay a fine. In the NBA the fine is 40% of every dollar that is over the specified cap, and all of this money is spread out at the end of each season, to each team that is under the cap. Some teams take advantage of this idea known by bloggers as “the Sterling Strategy.” The name comes from the L.A. Clippers’ owner Donald Sterling, because many believe he has built a lackluster team, and because they are under the salary cap, receive a large amount of revenue each year via other teams. (NBA Salary Cap Issues, 2005)

Finally, one of the biggest negatives of the salary cap system in the National Basketball Association is that the good teams are able to continue to dominate. There are notably good teams in the league, notably the Las Angeles Lakers, that continue to dominate their competition year-in and year-out. These teams are above the salary cap, so with the current system, they should not be able to continue to sign good free agents. However, that is not always the case. Many teams do not want to hand out a lot of money for old free agents, so the players will not get the big contracts that will take them too many of the teams that continue to lose. This means that if they are going to get paid the same to play for a team that hardly ever wins or a team that is always in the picture as a championship contender, they will usually pick the contender. For example, all-star Ron Artest left his team with an annual salary of almost $8.5 million to go to the defending champion LA Lakers where he would receive less than $6 million dollars a year. (Ron Artest Career Statistics). He wants to win, so he traded the money for the opportunity to win an NBA championship. (Berkshire, 2009).

**National Hockey League**

The National Hockey League (NHL), in the 2009-2010 season, has a salary cap of $56.8 million for each team for the year. In 2009, the minimum salary in the league is $500,000. The maximum salary that can be given to a single NHL player is $11.36 million. (Salary Cap, 2010) In the NHL, no player receives the maximum salary of $11.36 million at this point in time. According to CBS Sports, “Vincent Lecavalier, the top earning NHL player and centre for the Tampa Bay Lightning, earned only $10 million” (staff).

The positive aspect of the NHL’s salary cap is that it only has room to give one, maybe two, players a super high salary. This is a positive thing because the NHL, unlike Major League Baseball (MLB), cannot buy the team’s success because the cap prevents it. If the NHL has an average of a 22 man roster with a minimum and the team salaries are all the same, then the individual salary is $2,581,818. If the team has too many top players who want a lot of money, then the team could literally not continue due to lack of funds. This helps keep team’s athletic skill level from becoming great, to the point of being unbeatable.

**Major League Soccer**

The American soccer league, Major League Soccer (MLS) has a relatively low team salary cap. The team cap in the MLS is $2.3 million dollars, and the max salary for one player in the MLS is $415,000 (Salary Cap, 2010). This is low compared to the National Football League, National Basketball Association, and the National Hockey League, but it is extremely low compared to Major League Baseball's salaries.

However, there is an exception to the MLS's salary cap. The exception is known as the Designated Player Rule, also known as the Beckham Rule. The Designated Player Rule was established in 2007, and was implemented just before the trade of David Beckham to the LA Galaxy, a MLS team in Los Angeles, California. The Designated Player Rule "allow MLS to sign players whose salary will fall outside of the team salary budget and whose cost above the salary budget charge will be the financial responsibility of the club" (MLS Implements Designated Player Rule and Other Competition Initiatives).

The Designated Player Rule increases the marketing aspect of the MLS because of the ability to sign high ranking, European soccer (fútbol) by offering a very high salary, well above the league maximum salary. David Beckham, an English man formerly on Manchester United, is the man behind the Designated Player (Beckham) Rule. The MLS team LA Galaxy was able to acquire Beckham through this newly appointed rule in 2007. Beckham's annual salary through in his 5 year contract with LA Galaxy is $32.5 million, or $6.5 million per year. This is $6,085,000 over the standard maximum salary in the MLS (Designated Player Rule, 2010).

The positive of the MLS's salary cap is that teams cannot buy themselves a championship. This being because, even with the Designated Player Rule, one excellent player will not make a team champions. The player will be a great asset to the team and excellent way to help market a team's name, but it will not help to the extent of winning every match. The positive, for the individual player, of the MLS salary cap is that most players can have the confidence that they will not lose their spot on the team because of their team "purchasing" players from around the globe. The individual players in a sense, have more job security.

On the negative side however, soccer is a very vigorous sport, and very competitive. However, in Europe, there are no salary caps in their soccer leagues. Their players can be paid a lot more than players in the United States. With that in mind, the salary cap effects the United States' soccer teams negatively because they cannot attract as many European athletes. And with soccer being a bigger sport over in Europe, if the United States had more access to obtain European soccer players, then the sport's popularity might increase in the United States.

# Solution

We conclude that the most effective and efficient option in dealing with salary cap issues in the United States' professional sports dilemma would be to compensate athletes with a performance-based salary. Performance-based salary would provide athletes with compensation directly reflective of their athletic performance for the year. We feel that this would eliminate many of the issues with the previous mentioned systems in American sports.

Under the performance-based system, players would be automatically compensated yearly with the league's minimum base pay. After the completion of the season, compensation will be given to players based off of personal and team awards, records, wins, etc. This leads to higher incentives for athletes to perform at their maximum potential and capability.

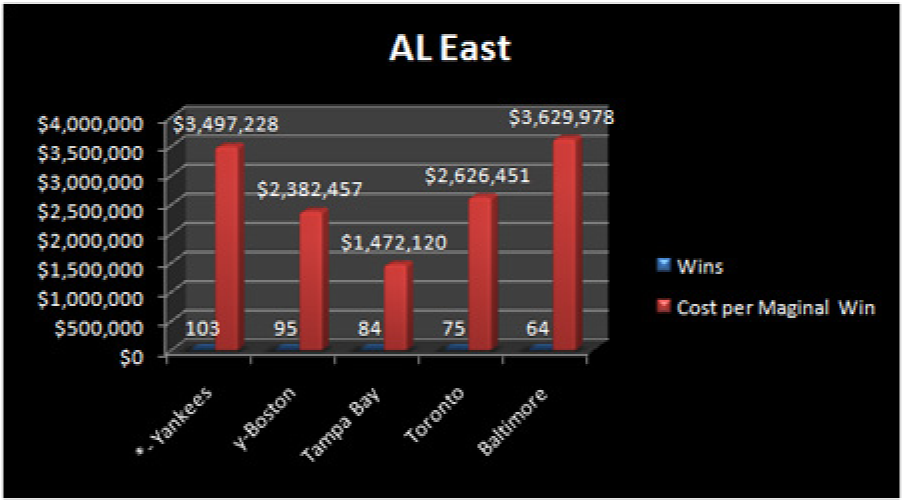
This also solves the problem with competitive balance because players can no longer have multi-million dollar contracts while not playing. Finally, in regards to competitive advantage, athletes will not be prone to compete for certain teams (New York Yankees) because their salary will be generally the same. They will not be able to go to teams just because the teams have the money to pay them a very high salary.

An example of how this performance-based salary would be effective is in the NBA. Tracy McGrady, a Houston Rockets star, is one of the highest paid NBA players. However, he does not play that much. So far in the 2009-2010 season, he has only played 46 minutes total. With his annual salary of around $22,000,000, if he does not play anymore the rest of the season, he stands to make around $500,000 per minute played (New York Knicks). With the performance-based salary, situations like this will not occur. There will not be players who sit on the bench with multi-million dollar contracts. If a top player must sit out, they will still make the league minimum. However, they will not be compensated as if they had dynamically contributed to their team's success or failure.

We understand that most professional athletes will not agree with our proposition, but it will work in the long run. A lot of the times when athletes become troubled with their financial situation with their payment players tend to go on strike. However, once the performance-based system is implemented, players will eventually return realizing that they are better off with the new system than working somewhere else.

| 2009 Marginal Payroll/Marginal Wins | | | | | | | |
|---|---|---|---|---|---|---|---|
| **EAST** | **W** | **L** | **PCT** | **Opening Day Payroll** | **Marginal Payroll** | **Marginal Wins** | **Cost per Marginal Win** |
| *-NY Yankees | 103 | 59 | .636 | $201,449,189 | $190,249,189 | 54 | $3,497,228 |
| y-Boston | 95 | 67 | .586 | $121,745,999 | $110,545,999 | 46 | $2,382,457 |
| Tampa Bay | 84 | 78 | .519 | $63,313,034 | $52,113,034 | 35 | $1,472,120 |
| Toronto | 75 | 87 | .463 | $80,538,300 | $69,338,300 | 26 | $2,626,451 |
| Baltimore | 64 | 98 | .395 | $67,101,666 | $55,901,666 | 15 | $3,629,978 |
| **CENTRAL** | **W** | **L** | **PCT** | **Opening Day Payroll** | **Marginal Payroll** | **Marginal Wins** | **Cost per Marginal Win** |
| x-Minnesota | 87 | 76 | .534 | $65,299,266 | $54,099,266 | 38 | $1,419,928 |
| Detroit | 86 | 77 | .528 | $115,085,145 | $103,885,145 | 37 | $2,800,139 |
| Chicago Sox | 79 | 83 | .488 | $96,068,500 | $84,868,500 | 30 | $2,791,727 |
| Cleveland | 65 | 97 | .401 | $81,579,166 | $70,379,166 | 16 | $4,291,413 |
| Kansas City | 65 | 97 | .401 | $70,519,333 | $59,319,333 | 16 | $3,617,033 |
| **WEST** | **W** | **L** | **PCT** | **Opening Day Payroll** | **Marginal Payroll** | **Marginal Wins** | **Cost per Marginal Win** |
| x-LA Angels | 97 | 65 | .599 | $113,709,000 | $102,509,000 | 48 | $2,117,955 |
| Texas | 87 | 75 | .537 | $68,178,798 | $56,978,798 | 38 | $1,483,823 |
| Seattle | 85 | 77 | .525 | $98,904,166 | $87,704,166 | 36 | $2,409,455 |
| Oakland | 75 | 87 | .463 | $62,310,000 | $51,110,000 | 26 | $1,935,985 |
| **EAST** | **W** | **L** | **PCT** | **Opening Day Payroll** | **Marginal Payroll** | **Marginal Wins** | **Cost per Marginal Win** |
| x-Philadelphia | 93 | 69 | .574 | $113,004,046 | $101,804,046 | 44 | $2,292,884 |
| Florida | 87 | 75 | .537 | $36,834,000 | $25,634,000 | 38 | $667,552 |
| Atlanta | 86 | 76 | .531 | $96,726,166 | $85,526,166 | 37 | $2,286,796 |
| NY Mets | 70 | 92 | .432 | $149,373,987 | $138,173,987 | 21 | $6,456,728 |
| Washington | 59 | 103 | .364 | $60,328,000 | $49,128,000 | 10 | $4,723,846 |
| **CENTRAL** | **W** | **L** | **PCT** | **Opening Day Payroll** | **Marginal Payroll** | **Marginal Wins** | **Cost per Marginal Win** |
| x-St. Louis | 91 | 71 | .562 | $77,605,109 | $66,405,109 | 42 | $1,566,158 |
| Chicago Cubs | 83 | 78 | .516 | $134,809,000 | $123,609,000 | 35 | $3,562,219 |
| Milwaukee | 80 | 82 | .494 | $80,182,502 | $68,982,502 | 31 | $2,196,895 |
| Cincinnati | 78 | 84 | .481 | $73,558,500 | $62,358,500 | 29 | $2,121,037 |
| Houston | 74 | 88 | .457 | $102,996,414 | $91,796,414 | 25 | $3,614,032 |
| Pittsburgh | 62 | 99 | .385 | $48,693,000 | $37,493,000 | 14 | $2,736,715 |
| **WEST** | **W** | **L** | **PCT** | **Opening Day Payroll** | **Marginal Payroll** | **Marginal Wins** | **Cost per Marginal Win** |
| *-LA Dodgers | 95 | 67 | .586 | $100,414,592 | $89,214,592 | 46 | $1,922,728 |
| y-Colorado | 92 | 70 | .568 | $75,201,000 | $64,001,000 | 43 | $1,474,677 |
| San Francisco | 88 | 74 | .543 | $82,616,450 | $71,416,450 | 39 | $1,812,600 |
| San Diego | 75 | 87 | .463 | $43,734,200 | $32,534,200 | 26 | $1,232,356 |
| Arizona | 70 | 92 | .432 | $73,516,666 | $62,316,666 | 21 | $2,911,994 |

* - Won Division     y - Won wild card

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| *- Yankees | 103 | $3,497,228 |
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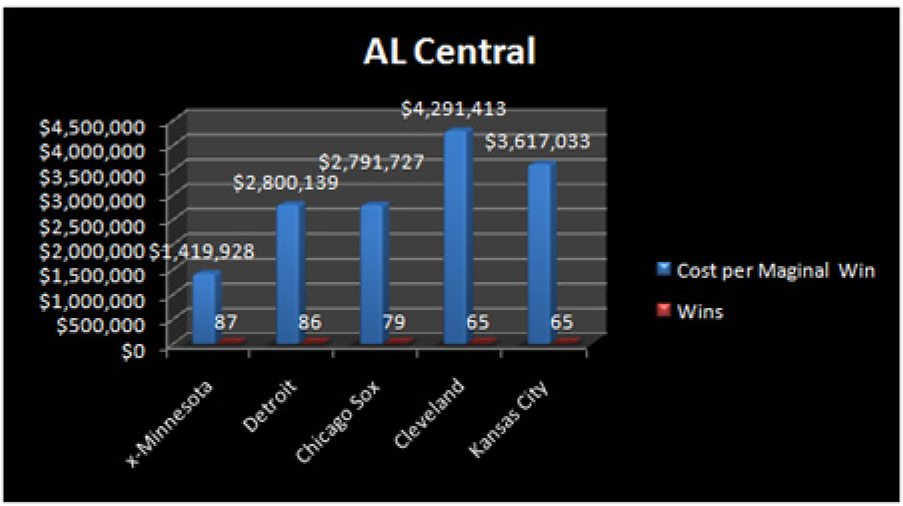


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| Detroit | 86 | $2,800,139 |
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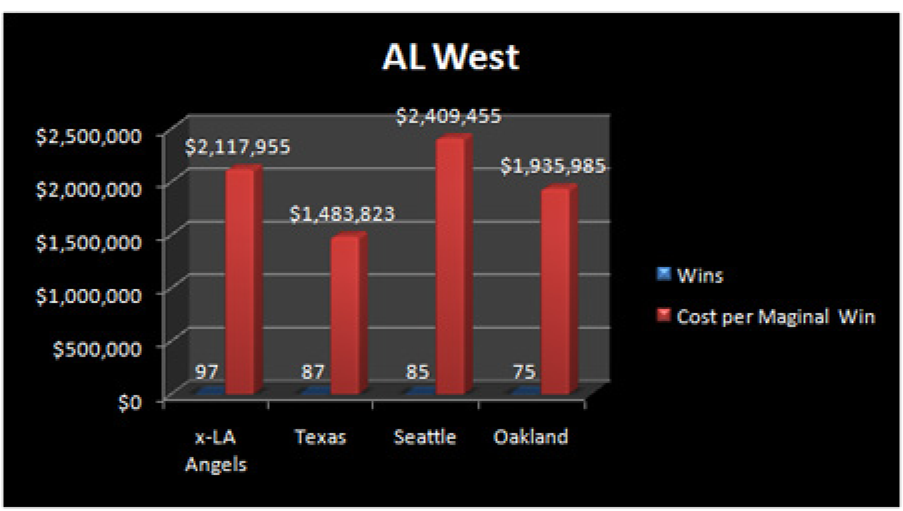
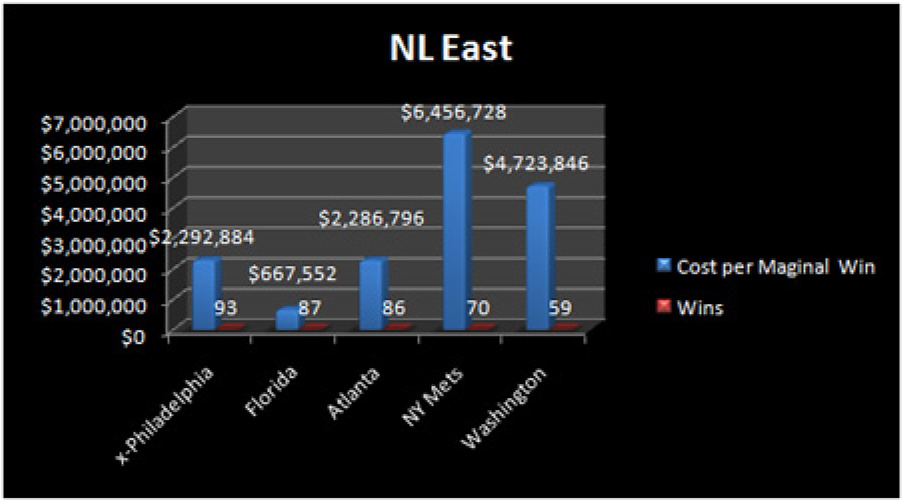



| AL WEST | Wins | Cost per Marginal Win |
|---|---|---|
| x-LA Angels | 97 | $2,117,955 |
| Texas | 87 | $1,483,823 |
| Seattle | 85 | $2,409,455 |
| Oakland | 75 | $1,935,985 |




| NL EAST | Wins | Cost per Marginal Win |
|---|---|---|
| x-Philadelphia | 93 | $2,292,884 |
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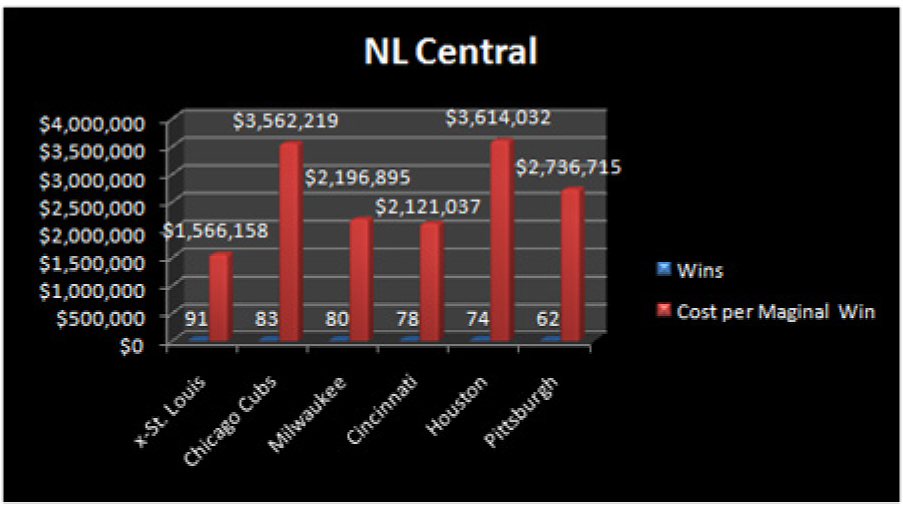


| NL CENTRAL | Wins | Cost per Marginal Win |
|---|---|---|
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| Chicago Cubs | 83 | $3,562,219 |
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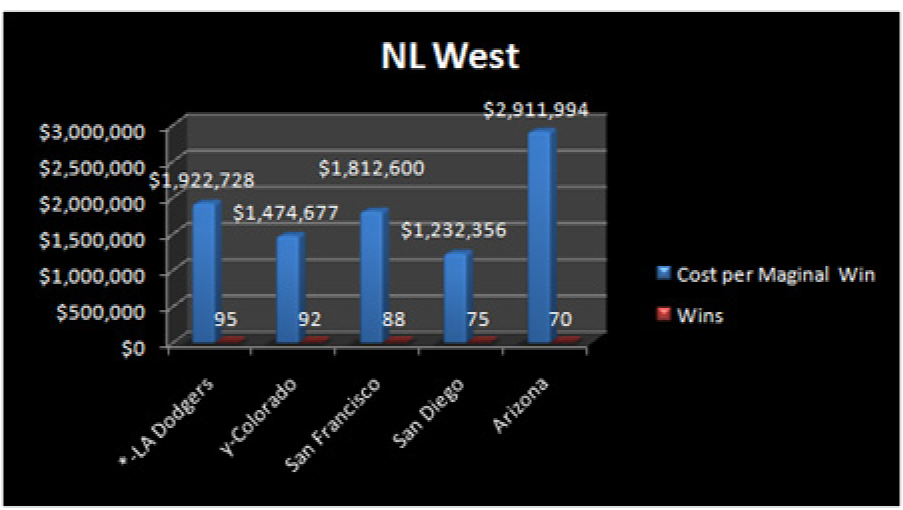


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