

# Thinking (Some More) About Competitive Balance

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Sanderson and Siegfried (henceforth, S-S) (2003) thoroughly cover most of the bases on competitive balance. But no single article can do everything. In this brief comment, I offer four areas for even further thinking on competitive balance.

## WHAT DO WE GAIN BY ANALYZING COMPETITIVE BALANCE?

Analyzing competitive balance seems to produce insights in two fundamental areas. On one hand, we can evaluate the efficacy of league and government competition policy choices. On the other hand, following the large uncertainty of outcome literature, we can evaluate the impact of competitive balance on fan demand both during the season and between seasons in the playoffs.

This is more interesting than it might seem at first, because it helps explain a current point of confusion concerning the actual measured behavior of competitive balance itself and the level of concern over competitive balance. Within-season competitive balance in baseball has improved generally by decade. The 1990s are a bit of a roller-coaster ride, but recent seasons prove that this decade was no exception to this general trend. In addition, although the names of the larger revenue market teams change occasionally, competitive imbalance remains much, as always, in the playoffs. *But fans and other observers seem increasingly dissatisfied with this state of affairs* (although I am unaware of any comprehensive historical analysis that actually finds this is true).

There is no paradox here once we recognize something important. Quality of competition is simply a preference issue, and preferences can change over time. Fans can feel however they want to about competitive balance! And economists may find the impact of quality of competition affects demand more now than ever despite the observed fact that competitive balance as a measurable attribute of league outcomes has not worsened.

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Because the issue is of preferences rather than the actual behavior of competitive balance itself, the psychology of preference formation may hold the key to insights about current feelings on competitive balance. People's perceptions may seem puzzling compared to historical outcomes, but people form those perceptions and act on them just the same. We can argue until the Red Sox win another World Series about the validity of fan perceptions, but that will not help us understand the impact of the exercise of those preferences.

#### WHAT IS THE OPTIMAL LEVEL OF COMPETITIVE BALANCE?

S-S (2003) make the often overlooked point that ideal balance, like love, is a many-splendorous thing. The continuum of possibilities runs from the lopsided outcomes of Nebraska football to the closeness of outcomes deciding National Football League (NFL) playoffs. A current definition popularized by the Blue Ribbon Report (BRR) (Levin, Mitchell, Volcker, & Will, 2000)<sup>1</sup> and Costas (2000) lies somewhere in between: Each fan has a recurring and realistic preseason hope that their team is a playoff contender.

Fans and sports commentators are free to argue from the heart, but analysts need to recognize that they must *play within themselves* on this issue. In terms of the economist's limited ability to make welfare statements, the only real guidance we have about optimal competitive balance comes from our understanding of the power of competition. Roger Noll and Ira Horowitz pointed out in Congressional testimony in 1976 that splitting up leagues would make them economically competitive. Roughly a decade later, Stephen Ross (1989) sketched out what an economically competitive outcome might look like. But let us be realistic. Judging from the response to my efforts in the area (Quirk & Fort, 1999), an economically competitive outcome in sports leagues almost certainly will not be judged ideal on very many dimensions. So let us be clear. When we launch into long discussions of improving competitive balance, we are not standing on a solid welfare-theoretic platform.

#### HOW SHOULD LUXURY TAX REVENUES BE DISTRIBUTED?

S-S (2003) state that luxury tax revenues should go to those bearing the costs of large revenue market-talent externalities. This is a sentiment I have seen, again, from the BRR (Levin et al., 2000) recommendations and Costas (2000). It also seems that the same sentiment underlies the existence of Commissioner Selig's *discretionary* pool from Major League Baseball (MLB) revenue sharing. Payments from that pool should go to reward smaller revenue market teams that perform above some expected level.

But surely this prescription rests on a particular implicit assumption about fairness. I suspect that supporters of this distribution of tax revenues are caught up with the idea that the revenues *should* be used in ways that lead smaller revenue market

owners to spend on talent because that is fair. Competitive balance *should* come out of larger market owners' hides, but smaller market teams *should not* be able to just take the money without investing it in talent. All are clearly heartfelt but normative statements.

Getting back to basics, let us give the Rottenberg-Coase logic free rein; *obtaining the efficient talent distribution in the face of talent choice externalities does not depend on the distribution of the tax revenues*. Indeed, if the externality is eliminated through taxation, forcing smaller revenue market teams to buy more talent than will be released by larger revenue market owners under the tax creates its own inefficiencies. Unlike the case of nearly complete revenue sharing in the NFL, smaller revenue market owners in baseball are *not* choosing inefficiently in the first place. Larger revenue market owners are the ones creating the externality. By the way, let us not forget the ultimate irony of the Rottenberg-Coase logic: The efficient talent distribution can be had by *paying larger revenue market owners* to reduce their talent choice!

This suggests that there should be a fuller debate over the fair distribution of the tax revenues. Without wedding myself to their support, here are two ideas. Play cannot happen without all the teams in the league. A lump sum subsidy would not be predicted to alter smaller revenue owners' profit-maximizing talent choices after the tax is in place, but it would offer an additional return to those owners that some people would view as fair. Or, luxury tax revenues could be used to reduce public stadium subsidies—a use that many more would probably find fair. A central stadium fund not unlike the NFL's loan fund, financed out of luxury tax revenues, would do the trick. But regardless of the results, society potentially wastes opportunities without entering into the debate in the first place.

#### LEST WE FORGET. . .

Ultimately, doing something about competitive balance is to be a political activity. The root cause of competitive imbalance in baseball is the power MLB has over team location and expansion. It is this power that creates market areas of different value in the first place. The maintenance of territorial exclusivity entrenches these different values and the competitive imbalance that follows. Owners continue to hold this power (and not just in baseball) for political reasons developed elsewhere (for a summary, see Fort, 2003, chap. 11). It follows that efforts to remedy competitive imbalance in baseball will eventually confront the internal and external politics of league power over expansion and team location. In addition to understanding the ins and outs of the usual mechanisms to enhance balance (luxury taxes, salary caps, etc.), a solid application of rational actor political modeling should generate a more complete understanding of why competitive imbalance is alive and well in MLB and should be expected to remain so.

## NOTE

1. References for the three competitive balance panelists' remarks—Fort, Humphreys, and Kahane—are integrated into the list of references at the end of the Sanderson and Siegfried (2003) article.

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