CAN A TAX PLAN SAVE BASEBALL?

by Ray C. Fair, Professor of Economics,
and Sharon M. Oster,
Professor of Economics and Management
Yale University, New Haven, Connecticut

EDITOR'S NOTE: On August 8, 1994, the authors had circulated a wage-tax proposal to Major League Baseball players and owners that could serve as a compromise in order to settle the baseball strike. This article is based on that wage-tax proposal.

As parents of two avid baseball fans, ending the exciting 1994 baseball season with a strike was quite discouraging. It seems clear that the salary cap will not pass muster with the players and equally clear that the owners will hold out for some change. While both the owners and players seem adamant in their positions, we have a suggestion for a compromise that might be acceptable to both sides.

The main problem from the owners' perspective is the rapid increase in players' salaries. From 1980 to 1991 average baseball salaries increased six fold, considerably faster than salaries in most other pro sports. At least some baseball franchises appear to be losing money. The owners have demanded some relief from competition among themselves for players, some mechanism to encourage them to show mutual restraint. The salary cap, used in some other major sports, is their current proposal. The players are resisting the salary cap with an intensity which has resulted in a long and bitter strike, and they point to the large revenue increases of the owners over the past decade, increases due in large measure to the players' talents.

Our proposal requires compromise on both sides, as any solution in the long run will. It does not, however, require a salary cap, which seems clearly a non-starter. The proposal is for owners to pay a fee into a fund whenever they pay a salary above a specified level. The fee would be a certain percent of the salary above the specified level, and both the level and the percent would be agreed upon by the players and owners. If, for example, the specified level were $2 million per year and the percent were 30 percent, a salary of $4 million for a player would cost the owner $4 million plus $600,000 to the fund. This fee would do nothing to encourage players to move across teams because they would not receive the fee. It would, however, increase the cost to owners of high salaries and thus lessen the incentive for owners to pay high salaries.

The money contributed to the fund would also have its use. At the end of the year it would be divided in an agreed upon portion between the owners and the players. The players' union could do whatever it wanted with its share. One possibility is simply to pay an equal amount to each player, and another is to put the money into the players' retirement fund. Whatever the union decides to do with the money, it is likely that it will do so in such a way as to benefit the players at the lower end of the salary scale more. This would thus have positive redistributional effects among the players.

Likewise, the owners' group could do whatever it wanted with its share. One possibility is simply to give each franchise 1/28th of the share, and another is to give the less profitable franchises more. Whatever is done is likely to have positive redistributional effects among the franchises.

This plan should appeal to the owners because its major thrust is to reduce their incentive to pay high players' salaries by making it more expensive for them to do so. Although the plan may not be as appealing to the owners as the salary cap, it does go some way in encouraging owners to show mutual restraint. It also has the advantage over the cap of giving owners more flexibility: an owner could decide to invest heavily in some players and thus contribute significantly to the fund.

...it is clear that compromise on both sides is needed to end the baseball strike. The players must realize that some non-trivial tax is needed to satisfy the owners...

Clearly the players give something up with this proposal, as they are likely to have to do in any final settlement. On the other hand, the plan is less draconian than the salary cap. Also, the fact that the fund is shared with the players' union will benefit players at all salary levels.

As in any labor-management dispute, there are many details that can only be worked out over the bargaining table. If, however, the players and owners agree on the broad outline of this proposal, working out the other issues does not seem insurmountable, given the enormous cost to both players and owners (and our children) of a prolonged strike. What does seem insurmountable at the moment is the drawing of the line in the infield over the salary cap. The present proposal avoids this line and may provide enough flexibility for a settlement.

The most recent news on the sports front is the settling of the NHL labor dispute. That settlement — widely viewed as a victory for the owners — came without a tax. The owners relied on a device from earlier sports history: the postponement of free agency. Instead of tinkering with market forces like the tax does, hockey owners have managed to prolong the period during which players are removed from the market. It is not clear that this is the way that baseball players want to go. A tax proposal like the one just outlined is clearly less draconian than the proposal the hockey players accepted.

It is clear that compromise on both sides is needed to end the baseball strike. The players must realize that some non-trivial tax is needed to satisfy the owners. It is unlikely that the owners will settle without some mechanism that increases their cost of paying high salaries. On the other hand, the owners must realize that the tax cannot be so high as to effectively make a salary cap. • • •