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The Effect of Market Size on the Competitive Balance of Major League Baseball

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THE EFFECT OF MARKET SIZE ON THE COMPETITIVE BALANCE OF MAJOR LEAGUE BASEBALL

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The advent of free agency in Major League Baseball in 1976 and the gradual withdrawal of restrictions on this "freely competitive" labor market has resulted in dramatic increases of player salary levels. The purpose of this project is to test the contention made numerous times by league ownership that this escalation of salaries has a negative impact on the competitive balance of the sport. More specifically, it exploits the total revenue differential between clubs located in big media markets and those located in small media markets. Owners claim that small media market teams cannot possibly continue to finance player payrolls at their current levels. These small media market teams will therefore be unable to competitively bid on the top players available through free agency each year and only be able to attract inferior talent. As a result, the competitive balance of the league will suffer. A test of the owners' assessment of the problem took the form of three hypotheses. First, since the emergence of the most unrestricted free agency rules to date in 1985, there has been no significant improvement in the competitive balance of Major League Baseball. Second, because of a comparative advantage in annual total revenue generation, big market teams will spend more on their average annual player payrolls than the small market teams. Third, if big market teams are able to spend more than small market teams on labor, they will be able to attract better talent, resulting in more average wins per season than their small market counterparts. A revenue-sharing/salary-cap proposal is examined as a measure that would equalize the teams financially. Although a competitive balance problem and significant payroll differences were proven to exist, a direct relationship between revenue and success in terms of wins per season was not conclusively established.