Salary cap: sporting or financial regulation?

Definition and modalities

The salary cap is a limit on the payroll of teams in a professional league, implemented mainly in North America. It was introduced in 1983 for the NBA, 1994 for the NFL, 1996 for the MSL and 2005 for the NHL. Other professional sports organisations also apply it in Australia (basketball, football, rugby union), England and France (rugby union) and Eurasia - Russia, Finland, China, Latvia, Belarus, Kazakhstan (ice hockey).

The salary cap is one of the features of the labour relations that is collectively negotiated between the club owners and the players' representatives. It is the amount of the league's revenue from the sporting spectacle that is distributed to the players, which is on average between 50 and 65% depending on the league and the era. By dividing this overall amount by the number of teams, we obtain a maximum and identical wage bill for each club.

If there is a disagreement over revenue sharing, a players' strike can be called and lead to a suspension of matches for a significant time (a few days, a few months, even a season or more). In this case, the owners 'lock out' their teams and temporarily lay off the players. Over half a century, there have been more than twenty lockouts in the four North American leagues concerned.

There are usually two types of salary caps. 'Hard' caps which lead, in case of non-compliance, to heavy fines (a "luxury tax"), contract cancellations, or even exclusion from the rookie draft or the league and are applied in the NFL, NHL and MLS. 'Soft' caps allow for overages and numerous exceptions, in some cases with the payment of a tax (NBA). Thus, more than two-thirds of NBA teams frequently do not respect the authorised payroll. In addition to these salary ceilings, some leagues have salary floors that can represent between 75% (NHL) and 90% of the maximum wage bill (NFL, NBA).

The various ways club owners in the NFL have circumvented the cap (rearranging contracts over time or deferring payments to stay under the cap) have softened the contract, with several franchises regularly exceeding the cap. Two selected examples from the NBA and MLS illustrate the weakening of the salary cap's regulatory power through these waivers.

The Larry Bird Exception (named after the Boston Celtics superstar) has allowed basketball clubs to sign players outside the salary cap since 1983, within a defined time limit but without financial constraints, as long as they have been playing for several years in their ranks and are therefore free agents. This is how the salary of another NBA superstar, Michael Jordan, who alone exceeded the Chicago

Bulls' salary cap by 30%, was excluded from the salary cap at the end of the 1990s, as was more than 15% of the league's workforce.

The Beckham Rule, introduced in 2007 when Los Angeles Galaxy signed David Beckham, authorises the exemption of three players' salaries from inclusion in the cap. The purpose of the rule is to give franchisees the means to attract foreign superstars and thus accelerate the sporting and commercial development of MLS through their fame and talent.

Objectives

Originally, the first salary cap designed by the NBA in 1983 was intended to restore the league's profitability, as two-thirds of the franchises were loss-making and the occupancy rate of the venues did not exceed 58% in the early 1980s. To balance the league and maintain the uncertainty of the outcome to maximise profit, competition in the labour market cannot efficiently regulate the sporting competition. Indeed, if teams are free to recruit the best players, the overbidding between them will result in the wealthiest teams monopolising the best talent. This will widen the competitiveness gap between clubs and deepen the pay gap between athletes. There will also be an increase in salaries, with the risk of bankruptcy in a business with low productivity gains due to the fixed number of players on the pitch.

Alternatively, limiting the dispersion of the wage bill can contribute to a fairly even distribution of talent. When teams are subject to both wage bill ceilings and wage bill floors at similar levels, they sensibly have the same expenses and, consequently, the same sporting potential. The purpose of the minimum wage bill is to force small clubs to strengthen each season when they might be tempted to act as free riders in the league by not recruiting or only recruiting mediocre players.

The economic and sporting consequences

The influence of the salary cap on competitive balance varies according to its rules and the way it is applied or circumvented. It is true that the possible penalty for not respecting the salary cap is often financial, which does not constitute an effective deterrent for rich clubs who prefer to pay a fine and exceed the cap.

Nevertheless, the greater the gap between payrolls (one to three on average in the NBA and one to two in the NFL), the greater the concentration of titles. The share of final victories of the five most successful clubs in the history of the championships ranges from 73% for the NBA (high predictability of the sporting result) to 46% for the NFL (high uncertainty of the sporting result).

This indicator partly reflects the degree of regulation in the league: flexible salary cap (NBA) - strong talent equalisation (NFL).

In American football, too, a larger number of clubs can win than in basketball, including those in small towns with relatively low turnovers. Where there is no payroll control, the inequalities are even greater: from one to five in MLB. Competitive balance is more affected in the baseball league, with five clubs dominating, accounting for 70% of the titles.

The signing of a superstar with a very high budget places explicit opportunity costs on the franchise. With the NFL's hard cap, it is forced to give up many of the picks it could have financed with the same budget since it can only spend the same amount as others. Because of this financial constraint, the only way to build a competitive team is to constantly make choices that pay more than they cost.

From the point of view of the overall evolution of players' salaries, and over a ten-year period (1990-1999), the NFL's hard cap was more effective (+164%) than the NBA's soft cap (+389%). And over the same period, the other two major leagues that did not have this cap experienced strong salary increases: +237% in MLB and +380% in NHL.

The distribution of individual salaries is very heterogeneous, reflecting the relative effectiveness of regulatory mechanisms, or even their absence. Ten per cent of NBA players receive 40% of all distributed salaries. Despite the collective salary cap and the introduction of individual salary caps in some leagues, a great deal of inequality of remunerations remain: from 1 to 50 for example in the NBA. This dispersion is smaller in the NFL. The MLB has the greatest inequalities in its free operation.

The results of academic research into the impact of the salary cap on all clubs in a league are contradictory [Leeds, von Allmen and Matheson, 2018; Fort, 2011; Sandy, Sloane and Rosentraub, 2004]. Some consider the salary cap to be the most effective regulatory instrument for allocating talent and balancing competition, while others do not identify a significant impact in this respect.

Yet, there is some consensus amongst sports economists that the salary cap limits salary inflation and preserves the financial health of franchises. In truth, the real purpose of the salary cap, by restricting the overbidding that always benefits players, is to organise a transfer of income from players to franchise owners, thereby maximising profits.

Towards a salary cap in Europe?

In European rugby, England (since 1999) and France (since 2010) implement a salary cap with different limits and a rule that offers a competitive advantage to the English during European cups since they can remove two players per season from the calculation of their wage bill (Marquee Player System). The result being that English clubs can bid over their salary confinements to sign top players that French teams can neither attract nor keep in their squad.

However, the transposition and generalisation of such a regulatory tool seem problematic for several reasons. At the level of the national championships, the inequalities in club turnover and therefore in the wage bill raise the question of the cap level. If the average championship wage bill were taken as the authorised threshold, this would mean, for example, that PSG would have exceeded the salary cap in 2020, just with the two salaries of Neymar and Kylian Mbappé alone, even though the French club has around 30 first-team players. With a cap in place, the Parisian club would not be able to have as much talent. This would help balance the French Ligue 1 but would reduce the club's competitiveness in European competitions.

UEFA is currently considering the feasibility of a cap to redress the imbalance in European football. Given their extreme diversity in terms of turnover, legal status, tax and social security systems - all of which distort competition - it would prove more difficult to establish and enforce a common cap on clubs participating in European cups, than for national leagues.

How can the same cap be imposed on German, English, Spanish, French or Italian clubs as on Belarusian, Estonian, Georgian, Polish or Ukrainian clubs? Financial fair play is indeed the first form of regulation that exists, but it only limits clubs' expenditure to the amount of their income, which can be very different. Another legal difficulty lies in the territory covered by UEFA (55 countries), which does not coincide with that of the European Union (27 countries). Furthermore, UEFA does not have the authority to impose a salary cap on the hundreds of clubs that do not participate in the competitions it owns. (Champions League, Europa League).

The salary cap would not be sufficient to effectively regulate European competitions. It would also be necessary to review the sharing of commercial revenues from European cups in a more egalitarian way, such as modify the conditions of access to these competitions, reform the transfer system, the setting of individual salaries, etc. In addition, such a system would require prior negotiation and agreement between the national leagues, clubs and players' unions to be applied.

However, the European Club Association (ECA), which brings together the heads of the continent's top teams (Real Madrid, Barcelona, Bayern Munich, Juventus), is hostile to any changes that would jeopardise its financial and sporting advantages, which guarantee its lasting dominance. This is all the more true given that this powerful lobby regularly threatens to leave UEFA and create a closed Super

League based on the North American model, with the interested assistance of television channels and sponsors.

Further information:

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