Taxes: an effective instrument to fight against sport's market failures?

Definitions

Let us recall that an externality is defined as the impact of an agent's action on the well-being of others without this impact being taken into account by the market. If this impact is positive, we speak of a positive externality, if the impact is negative, of a negative externality. In the presence of such externalities, the market is no longer efficient and the equilibrium is no longer optimal. This is because externalities distort the optimisation calculations of rational agents since the market sends them price signals that are undervalued (positive externalities) or overvalued (negative externalities). This implies a misallocation of scarce resources and the market fails because it no longer plays its role of regulating the economy correctly. To put it another way, in the presence of externalities, there is a mismatch between social cost and private cost. If the externality is negative, the social cost is greater than the private cost and the market equilibrium results in a quantity traded that is greater than what would be optimal in the absence of externalities.

In general, to reach the optimum, private costs and benefits must coincide with social costs and benefits. The internalisation of external effects thus consists in leading economic agents to act as if the costs they impose on other agents or the benefits they receive from them were production costs or goods purchased on the market. Under these conditions, the market once again plays its regulatory role correctly, but beyond the principle, a mechanism for internalising external effects must be found. In economic theory, in the field of externalities relating to the environment, two solutions have been proposed: the one set out by Cecil Pigou in 1920, which gave rise to the polluter pays principle, and the one set out by Ronald Coase in 1960, which gave rise to the system of tradable permits.

The Pigouvian solution consists in making the person responsible pay a tax equal to the amount of damage caused. The essential problem lies, of course, in the determination of the optimal level of the tax that allows the equalisation of the social cost and the private cost. The amount of damage caused is not always easy to assess in monetary terms. In practice, such an amount is the subject of negotiations between stakeholders and the difficulty is often to arrive at a tax amount that is incentive-based, i.e., sufficient to induce a change in the behaviour of agents. In the case of a tax that is considered too heavy, the risk of a loss of competitiveness for businesses is denounced, especially in open economies if competitors do not do the same.

The Coasian solution consists in restoring property rights and setting up markets to exchange them. In the case of environmental pollution, if the producers hold the property rights, it is up to the victims to compensate them as a means to finance an anti-pollution process; if the victims are the owners, it is the producers who must compensate them. Moreover, Coase posed the hypothesis that there would be no transaction costs for this exchange of property rights to be effective.

Under perfect conditions, the Pigouvian solution (price regulation) or the Coasian solution (quantity regulation) lead to the same result in theory. From a practical point of view, however, economists have asked themselves which system is easier to implement. The hypothesis of the absence of transaction costs does not support the Coasian system, and in many fields, we have seen the introduction of taxes that have a double advantage: they make it possible to modify the behaviour of agents provided they are sufficiently incentivised (first dividend); they make it possible to collect resources that can be redistributed to improve the fight against the externalities denounced (second dividend). Sport has not escaped such a debate on the opportunity to introduce a certain number of taxes. We will take two examples of externalities with the sports labour market and player transfers, and with the sports entertainment market, which is undergoing numerous failures.

Failures in the professional sports labour market

A ‘Coubertobin tax’ on the transfer of young athletes was first outlined in principle, and then studied at great length, in its technical and financial aspects in the early 2000s. The aim is to curb the appropriation of talent from low-income countries by rich countries, free up new resources for the Third World to ensure real sporting development and reinforce the universal nature of competitions in accordance with the philosophy of Pierre de Coubertin, the innovator of the modern Olympic Games. This project of taxing sports transfers is in keeping with the idea of the American economist James Tobin, who in 1978 imagined a tax on international exchange transactions to discourage purely speculative movements and to allocate the revenue to development aid.

The growing number of transfers from the 1990s onwards to Europe (football) and North America (basketball, baseball) of young athletes under 18 years of age from Africa or Latin America raises moral, legal and economic problems caused by practices that are often illegal and clandestine. The continued liberalisation of the labour market and its unification have made it far easier for clubs in developed countries to access quality athletes cheaply. This massive recourse to talent from the Third World has increased to mitigate the consequences of rising wage costs for European or North American clubs.

This tax would cover all transfer fees and salaries stipulated in the first employment contract signed by athletes from developing countries with foreign clubs or agents. The host club and/or the agent would pay this tax, which could be collected by the national sport federations under the control of an ad hoc international organisation placed under the dual supervision of the UN and the IOC. The revenue from this tax would be used to finance, in the developing countries of origin, the construction of sports facilities, the creation of EPS programmes and the promotion of sport for all.

The feasibility and effectiveness of the Coubertobin tax are uncertain for several reasons. To be implemented and respected, all stakeholders must accept this tax: athletes, families, clubs, federations and agents. Otherwise, some operators would behave like free riders and continue to transfer athletes without paying the tax. To be effective, this tax must be generalised to all disciplines with a professional sector and applied worldwide. For its collection, as well as for its control, and the possible sanctions in case of fraud, the tax will entail control costs because there are risks of bargaining and corruption. The Coubertobin tax requires active cooperation between the sports movement, States and international organisations. This requires a common will to act and binding international legislation. Twenty years after its conception, the Coubertobin tax is still not in existence, even though it is regularly the subject of reflection, debate and proposals.

Failures in the sporting spectacle market

The sporting spectacle is subject to numerous cases of abuse: doping, financial doping, dirty money, tax havens, corruption, match-fixing, fixed betting, etc. All these abuses call into question the integrity of the sporting spectacle and constitute a danger to the sustainability of this sector of activity. Economists have therefore wondered whether the introduction of a certain number of taxes would allow for an effective fight against these plagues, under which the market is currently failing. For example, doping could be the subject of more applied economic thinking. Beyond the theory, we should try to determine in particular the amount of tax that would be a successful deterrent for the user of doping products.

Taxes already exist on commercial products linked to the sporting spectacle (television rights, sponsorship, sports betting). It would be necessary to better assess both their rate and their destination in order to rule on their potential efficiency (first dividend) and their social utility (second dividend). This work would also be interesting for analysing the conditions of implementation of these taxes in a highly competitive market at an international level. One of the difficulties encountered in the negotiations for their implementation is largely due to the heterogeneity of tax legislation at the European level. It is not possible to impose taxes in one country if all competitors are not subject to the same rules. Moreover, the denunciation of the heaviness of compulsory levies and the principle of fiscal neutrality limit the possibility of creating new sports taxes. Academic work is therefore needed to elaborate a global tax strategy that would allow the internalisation of the main diseconomies of sport. The imbalances are such today that the competitive balance of European championships is pure illusion. Moreover, it would be necessary to reflect on the use of the second dividend to support amateur grassroots sport, which constitutes the talent reserve of professional sport.

Further information:

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Gregory MANKIW, *Les principes de l'économie*, Economica, Paris, 1998.

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