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# Monopsony and competition: The impact of rival leagues on player salaries during the early days of baseball

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ABSTRACT

During the early days of professional baseball, the dominant major leagues imposed a "reserve clause" designed to limit player wages by restricting competition for labor. Entry into the market by rival leagues challenged the incumbent monopsony cartel's ability to restrict compensation. Using a sample of player salaries from the first 40 years of the reserve clause (1880–1919), this study examines the impact of inter-league competition on player wages. This study finds a positive salary effect associated with rival league entry that is consistent with monopsony wage suppression, but the effect is stronger during the 20th century than the 19th century. Changes in levels of market saturation and minor-league competition may explain differences in the effects between the two eras.

## 1. Introduction

Throughout most of its history, professional baseball regulated player salaries through the use of the "reserve clause." Introduced following the 1879 season, National League owners agreed to allow each team to reserve a list of five players who could not be signed by other league members. The reserve list was soon expanded to all players, which bound players' playing rights to a single team, creating monopsony power for league clubs by eliminating intra-league competition for players and thus restricting wages. Prior to the 1880 season, players operated on annual contracts, with players moving to the team that was the highest bidder. Owners realized that their profits were being hindered by competitive bidding for playing talent among themselves, which constituted up to two-thirds of operating costs.[1] By restricting players to a single team, owners had to pay players only enough to compensate them for forgone wages in other occupations that paid significantly less than baseball; therefore, owners should have been able to generate rents by paying players wages less than their marginal revenue products.

Economic theory predicts that competitive pressure drives employers to hire workers at wages approximate to their marginal revenue products. While this theory is widely believed, it is difficult to test in practice, as marginal physical products are difficult to measure in most labor markets. Scully (1974) introduced the method of using sports performance data to measure physical products and generate marginal revenue product estimates of workers. In a similar fashion, the competitive environment of professional baseball from over a century ago provides a unique opportunity to test the economic theory that entry should raise wages in monopsony and oligopsony labor markets.[2]

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[1] Seymour (1960) notes "The owners soon realized what was causing high salaries. It was competition among themselves for players. ...To meet the problem, League bosses began restricting competition for the services of players. They did this by introducing the famous reserve clause" (p. 106). Using a sample of 29 players from 1881 to 1889, Ashcraft and Depken (2007) estimates that introducing the reserve clause suppressed salaries by ten percent.

[2] Goff and Tollison (1990) states explicitly that sports leagues data "can test models of monopsonistic versus competitive labor markets" (p.8).

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Recent interest in imperfectly competitive labor markets has focused on identifying market power in specific industries.[3] However, the results of studies of monopsony effects on wages have been mixed, and Matsudaira (2014) notes that the lack of agreement among economists is largely due to the difficulty of generating direct empirical evidence of market power in hiring labor. These effects have not been largely explored in other markets because of a lack of appropriate salary and productivity data. Major League Baseball has long been considered a natural monopoly seller—due to its economies of scale—and a monopsony employer as the single employer of top-level baseball talent (Neale, 1964; Rottenberg, 1956). Thus, the rival league experience in baseball offers the opportunity to identify the extreme market power effect of a monopsony on wages that may serve as a comparison for other labor markets, where market power and productivity are more difficult to measure.

Analysis from this era is also applicable to modern sports leagues, where restrictions on competition in labor markets are universal across leagues around the world. Players are initially assigned to teams via a draft or signed as free agents and are not free to move to new teams. Teams value the rents of players who produce more than their marginal revenue products and may capitalize on them by selling or trading players to other teams, in some cases without the player's consent. These restrictions have faced considerable legal and legislative scrutiny in the past and will continue to do so in the future.[4] This analysis sheds light on the potential anti-competitive effects of such restrictions. Though the expectation of anti-competitive wage effects in sports labor markets is widely held by economists, empirical analysis of the impact of external competition from rival leagues has been sparse.

In recent history, available data have allowed economists to estimate and document the impact of Major League Baseball's use of monopsony power to lower player wages by restricting intra-league competition among teams.[5] These studies have also examined the effect of competitive pressure on free agents, and find that when players have teams competing for their services, wages approach estimates of their marginal revenue products. However, in the modern age, there have been no rival leagues to challenge Major League Baseball's market power; thus, there has been no opportunity to examine the effect of direct inter-league competitive pressure on player wages. Competition between cooperative owners of the same league may be different than competition between non-cooperating owners across leagues, because owners must frequently interact and cooperate to facilitate the operation of the league, which creates an opportunity for collusion. For example, in the mid-1980s—nearly a decade after players had negotiated a right to free agency—a series of arbitrators ruled that owners had colluded not to compete for free agents, ultimately resulting in a settlement of $280 million to the players. Major League Baseball also agreed to settle collusion allegations in the early-2000s as part of the 2006 Collective Bargaining Agreement. This collusion was possible largely due to the repeated interaction among owners in meetings and sharing of information, which would not be possible across rival leagues.[6]

The few existing studies of direct competition by rival leagues are unrigorous and inconclusive. Jones and Walsh (1987) examines the wage effects of the rival World Hockey Association on a sample of National Hockey League salaries in the 1970s, and the authors conclude that players' wages do not indicate a pattern monopsonistic exploitation when compared to marginal revenue product estimates. However, the sample examined is limited to a short period only during the rival league's existence—not in comparison to before or after the rival league—and thus its experimental structure is dependent on questionable marginal revenue product estimates. Ahlburg and Dworkin (1991) notes that salary growth in the National Football League in the mid-1980s was spurred by competition from the United States Football League, and Kahn (2000) notes that salary growth in the 1880s in baseball occurred when the National League existed concurrently with the American Association. However, these general conclusions are based on the simple interpretation of average aggregate data. Despite the history of rival league competition in sports, there is little empirical evidence to substantiate the predicted competitive effects of rival leagues.

In the earlier era of professional baseball, the incumbent National League experienced direct competition for major-league level talent from five rival leagues. When a new firm enters to compete against an incumbent monopsonist, economic theory predicts that wages should rise. Historical accounts of competition for players between leagues—colloquially referred to as "wars"—report that the competitive pressures had a positive effect on player salaries; however, this effect has never been established empirically. Newly-compiled salary data from this era provides sufficient observations to estimate the competitive effects of rival leagues on player salaries using appropriate statistical methods.

This article analyzes a sample of available player salaries from the first 40 years of baseball's reserve clause to examine the effects of rival league entry on player compensation. The analysis finds that rival league entry was associated with salary growth consistent with competitive pressure; however, the pressure did not necessarily result in rising salaries as might be expected from a simple model of competitive bidding. 20th century entries by the American League (1901–1902) and Federal League (1914–1915) were associated with salary growth for players; however, the effects were less evident during the 19th century. While entry provided opportunities for players to jump to higher bidders for their services, it also split the fanbase of baseball markets among many teams (e.g, during the Players' League entry), limiting the additional revenue that any team could garner by hiring additional quality players. In addition, incumbent league monopsony power may have been limited during its early years due to the geographic

[3] Card and Krueger (1995) argues that monopsony models of employment may be more applicable to certain labor markets than traditional competitive models. Bhaskar et al. (2002) provides a general description of the "new monopsony" economics literature on the market power of employers. For example, a strand of this literature has focused on estimating market power in the labor market for nursing (see Hirsch and Schumacher (2005), Staiger et al. (2010) and Matsudaira (2014)); yet, no definitive conclusion is reached.

[4] See Surdam (2015) for a history of legal and legislative challenges in professional sports.

[5] Scully (1974) and Sommers and Quinton (1982) estimate the dampening effect of the reserve clause relative to players' marginal revenue products. Zimbalist (1992), Krautmann (1999), and Bradbury (2010) estimate the wage dampening effects of early-career restrictions on player salaries relative to free agents.

[6] Beitler (2007) describes techniques developed by Commissioner Peter Ueberroth that created tacit understanding among owners that they would be better off collectively by restrained spending on free agents. Techniques included frequent meetings, reports on the risks of long-run contracts, publicly identifying owners who signed players to expensive contracts, and information sharing.

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