

Salary caps and competitive balance taxes: What are they and how do they improve competitive balance in sport?

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Aim of paper and research questions

The aim of this working paper is to examine the difference between a “Salary Cap” and a “Luxury Tax” and determine if they really do increase the competitive balance in professional sport.

Literature review

Since the majority of current literature examining the affect of salary caps and luxury taxes on the competitive balance of professional sports leagues tends to show that these restrictions on player salaries have no significant effect on parity, I wanted to examine what impact the induction of the new luxury tax in MLB in 2003 had had on competitive balance. The examination will spend particular attention to the impact the new tax’s redistribution policy has on the competitive balance of small market teams.

Research design and proposed data analysis

To examine the impact salary caps and luxury taxes have had on professional sports in America, the research reviews the year end results of the last 15 seasons of the NFL, NBA and MLB. The presentation will pay particular attention to the impact the “luxury tax” in Major League Baseball has had on the league since it was introduced in 2003. Using this data, and the year end team salaries in MLB, the research seeks to determine the potential impact of salary caps or luxury taxes.

Discussion of progress

The research is still in early stages of data collection. I should have all numbers and data needed by the end of the summer.

The presentation will begin by reviewing the two forms of salary caps currently used by American professional sports leagues: the “hard salary cap” used by the National Football League (NFL), and the “soft cap” found in the National Basketball Association (NBA). Next the presentation will examine the “luxury tax” found in Major League Baseball and show how the tax money is redistributed to small market clubs. Finally, the presentation concludes by examining the final standings of all teams under both the salary cap and luxury tax models and will try to determine if either model increased the competitive balance in the sports.

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