NCAA as Collusive Monopsony

Chapter 18

Collusive Monopsony

A monopsony is a market structure in which there is a single buyer of a good or service

This market structure is rare indeed, but collusive monopsony is not so rare

The NCAA is a good example of a collusive monopsony

NCAA’s members collude on two key inputs in the production of athletic competition:

- Student athletes
- Their coaches

NCAA Collusion

For students:

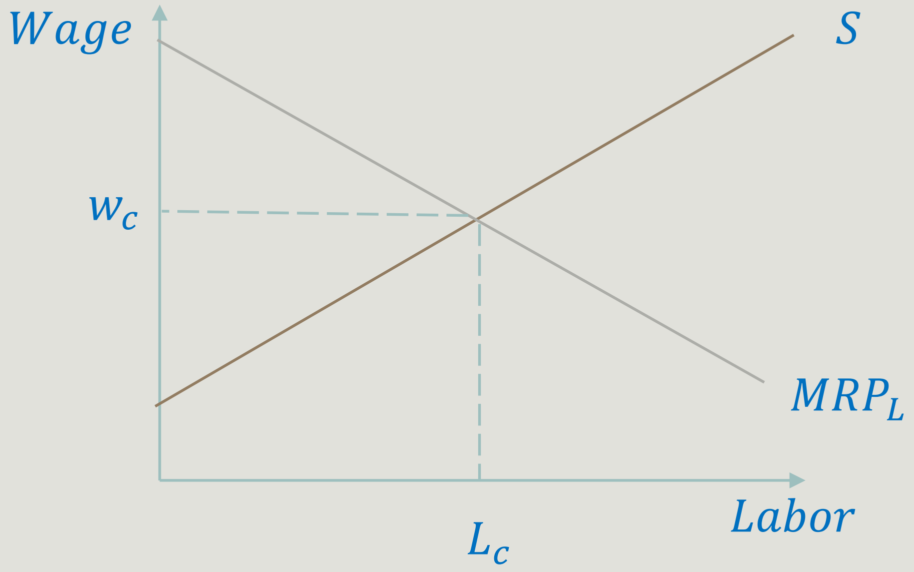
- The NCAA places a ceiling on the number of scholarships that a school may award in each sport
- Compensation is limited to room, board, tuition, books, and incidentals
- Bonuses for winning conference championships are limited to relatively inexpensive rings or watches

For coaches:

- Compensation of coaches is typically unconstrained, although there have been attempts to restrict earnings of some coaches

The Incentive to Collude

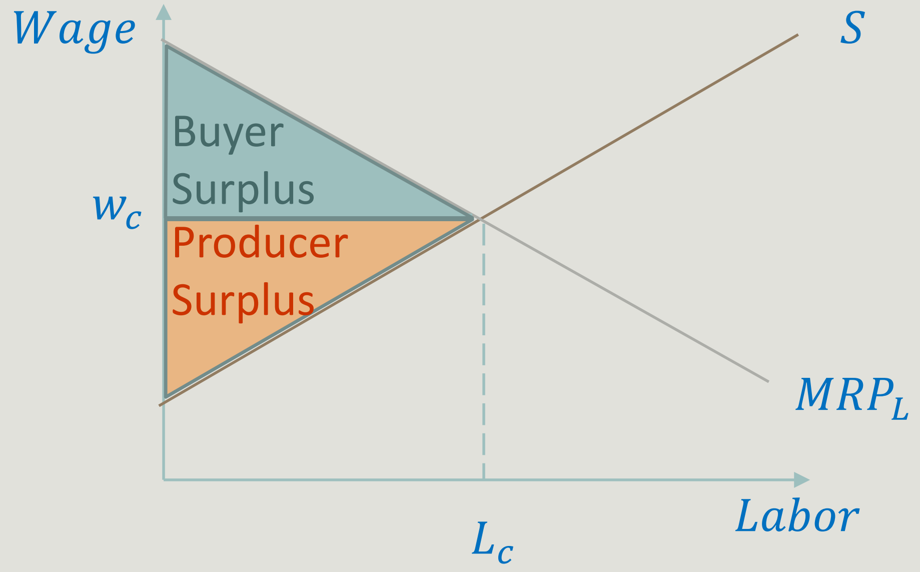
As we saw from last chapter, if the buyers behave independently, the forces of supply and demand will typically lead to a price and quantity that maximize social welfare



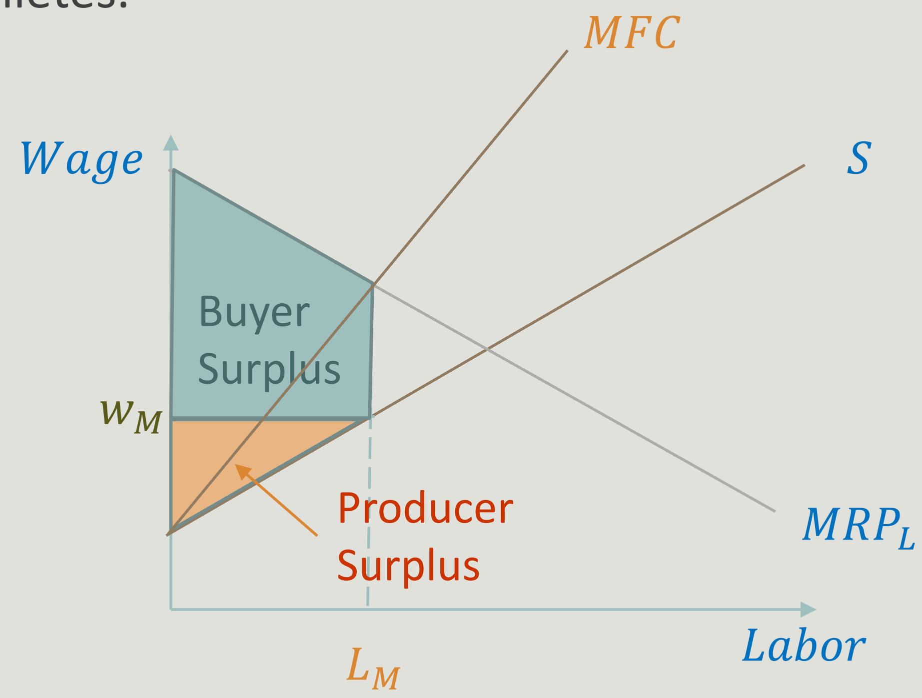
Perfect Competition

The Incentive to Collude

Buyers may be able to collude and use their collective buying power to increase their profits at the expense of the suppliers. Buyer surplus under monopsony is higher. The gains to NCAA members come solely at the expense of the athletes.



Perfect Competition



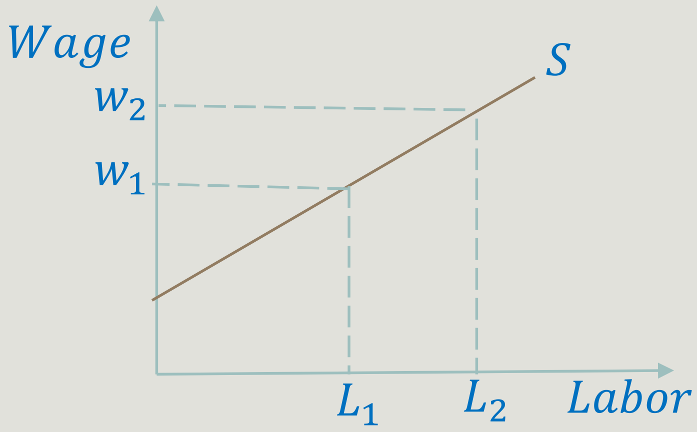
Monopsony

Effect on costs

When a buying cartel (like the NCAA) exercises monopsony power, it pays lower price for the input in question. This reduces the cartel's cost. One might think due to this reduction of cost that output would be greater and prices to the consumer would be lower, but this is not the case.

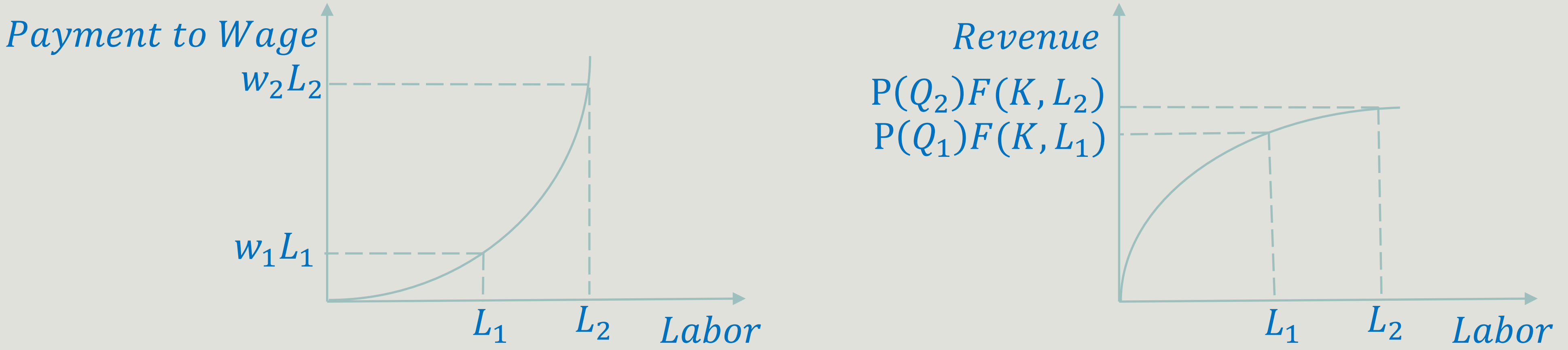
Marginal cost – change in total cost when output is increased by one unit.

Notice that when a monopsonist hires more labor, it moves along a positively sloped supply curve. Thus an increase in labor would have to increase wage.



Average Cost

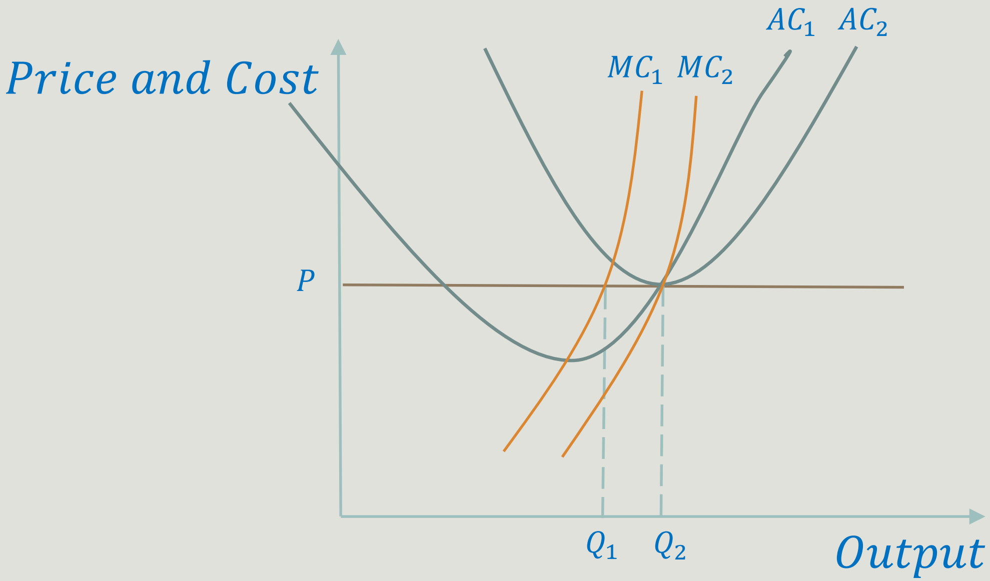
As we assumed before, capital is fixed (in the short run) and labor is the only input that can be varied. By increasing (decreasing) labor, we increase (decrease) output. Notice that while increasing labor increases output, it will also increase firm's payment to labor ($w(L)L$, where wage $w(L)$ is a function of L). The production function is concave and price $\mathrm{P}(Q)$ decreases in quantity (and thus decreases in labor), thus marginal revenue is decreasing over labor.



Average Cost

Profit incentive for behaving as a collusive monopsony flows from the effect on average cost.

By decreasing labor, we see that marginal cost decreases. Monopsony creates a gap, between the output price and the per unit cost. This gap (at Q_1) results in a profit.



NCAA Collusion

In addition to the limits on compensation, the NCAA limits the number of grants-in-aid that can be awarded in each sport (see table 18.1 in book). There are detailed rules regarding how one counts the student-athletes in the various sports and how to deal with those who participate in two sports. These details are important for closing loopholes.

In competing for the best athletes, schools can compete by hiring the best coaches who earn salaries in the $2 to $5 million range. They also compete by offering lavish training facilities, plush athletic dorms, upgraded training tables, etc. Notice that cartel profits fall when these expenses increase. Thus, it is in the collective interest of the NCAA's members to impose rules to curtail such expenditures.

Limits on Coaches

Limitations on coaches are fairly detailed for football, and less so for the other sports.

In Division I-A football, there is a limit of 1 head coach, 9 assistant coaches, and 4 graduate assistant coaches (as indicated in NCAA Division I Manual 2016-2017 subsection 11.7.4).

Table 18.2 lists the maximum number of coaches per sport (as of 2011).

Revenue Sharing

Each program is different and brings in different revenues.

In intercollegiate sports, gate receipts are shared with opposing teams, bowl revenues are shared within conferences, television revenues are shared, and the NCAA basketball tournament revenues are shared. Some revenue is not shared (for example: private donations, concession revenues, and licensing fees, thus some cartel members are going to be much better financially than others. **This financial imbalance cannot be completely eliminated as there is a danger that the most powerful athletic programs could defect from the NCAA.** In the NCAA, the revenue-sharing formula has evolved over time to prevent the defection of a coalition of the most powerful athletic programs.

Sanctions for Cheating

The NCAA has developed sanctions to deal with cheating on the cartel rules by member institutions. The purpose of these sanctions is to deter cheating by making it unprofitable to cheat. Some of these sanctions include:

- Elimination of revenue sharing
- Reduction in the number of grants-in-aid
- Reduction in television appearances
- Reduction in bowl appearances
- Ineligibility for championships

In extreme (but rare) cases, the NCAA may issue the “death penalty” by suspending a program for a period of one or two years. Recovering from the death penalty is extremely difficult (as was with the case of SMU). The message sent by the NCAA (by imposing the death penalty) is that flagrant cheating will be punished severely.

Antitrust Challenges by Coaches

Hennessey v. NCAA:

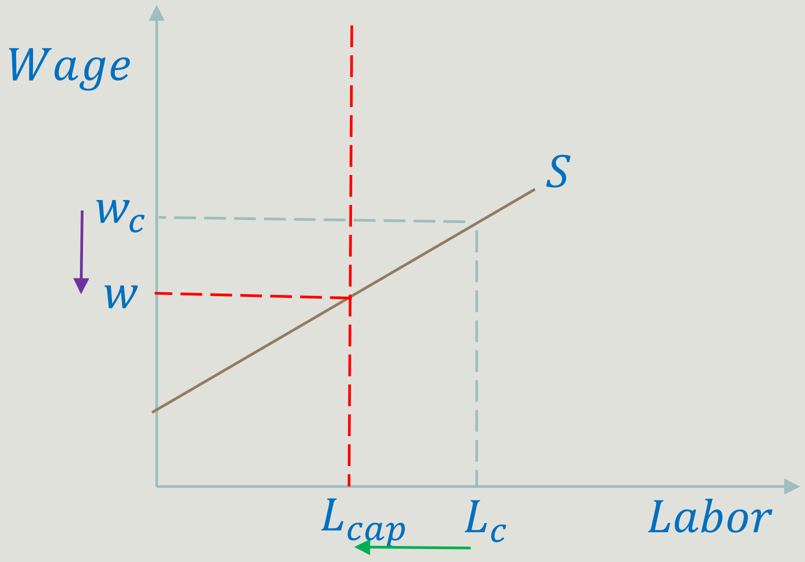
- In 1975, the NCAA members agreed to limit the maximum number of assistant football and basketball coaches (at Division I schools). As a consequence, an assistant coach, Hennessey, was demoted to part-time status. His compensation was reduced from $20,000 to $2,100. Hennessey filed an antitrust suit against the NCAA, alleging that the NCAA's agreement on the number of coaches violated Section 1 of the Sherman Act.

- Court found that indeed the NCAA Bylaw had restrained trade, however the question was whether the agreement constituted an *unreasonable* restraint of trade. In this connection, the court noted an absence of specific intent to injure the named plaintiffs or other assistant coaches, either individually or as a group.

Antitrust Challenges by Coaches

Hennessey v. NCAA:

- Notice that there was a lack of economic understanding. If the supply function of assistant coaches has a positive slope. Thus an agreement to reduce the number of assistant coaches hired has two effects:
  - Some coaches will lose their jobs entirely or be demoted
  - There is movement along the supply curve to a lower wage for those who remain employed



Antitrust Challenges by Coaches

Hennessey v. NCAA:

- One of the main arguments for the NCAA's behavior in this case (and others) is that it wants to preserve amateurism
- This is of course a sham as everything about Division I football and basketball is big business
- There was no proof that this restraint would save intercollegiate athletics, and the court did not demand any such proof
- The court argued that without the restraint, and the consequent cost saving, financially strapped programs might have to shut down, which means that in the long run there would be an increase of number of potential employers above the free market level. This of course is not true.

Law v. NCAA

In order to reduce costs, the NCAA Cost Reduction Committee decided to reduce the number of coaches in all Division I sports. In addition, every sport besides football would have a restricted earnings coach. The restricted earnings coach could not receive compensation greater than $12,000 during the academic year and $4,000 during the summer. Some of the coaches that had been affected had been earning $60,000 to $70,0000 annually.

The court conceded that the NCAA plays a vital role in making intercollegiate athletic events available to the public. At the same time, however, the court expressed its belief “that the Supreme Court [did not intend] to give the NCAA *carte blanche* in imposing restraints of trade of trade on its member institutions or other parties because of its role in the marketplace. There can be no doubt that the NCAA is subject to the antitrust laws.”

Law v. NCAA

The court found that the NCAA was involved in anticompetitive behavior.

The response from the NCAA was that the rule was necessary to maintain “a level playing field in the sports arena, retaining and fostering the spirit of amateurism…, and protecting NCAA member institutions from self-imposed, ruinous cost increases.

The problem is that it is the athlete – not the coach – who is supposed to be an amateur. The effect of the rule at issue would tend to weed out competent, experienced coaches and to weaken the quality of the coaching staff. This would tend to reduce the quality of the athletic performance. This would reduce the quality of “output” and thereby reduce social welfare.

No evidence was found to support the NCAA’s claims. The court found in favor of the plaintiffs.

Antirust Challenges by Student-Athletes

NCAA must have some leeway to impose rules that are designed to promote parity among teams. These rules do restrict competition in the market, but without parity, games would be lopsided and less attractive to both live and broadcast audiences.

In each of the cases discussed in the next slides, the underlying antitrust question should be whether the restraint in question is necessary for the NCAA to compete with other sellers of entertainment products.

In re: NCAA I-A Walk-on Football Players Litigation

Issue in question: limit on the number of football player grants-in-aid. Walk on players argued that if it wasn't for this limit, they would have received scholarships.

Analysis: in an anticompetitive sense, the question should be whether increasing the number of scholarships would jeopardize the quality of the products sold by the NCAA, which is competition on the field. The answer to this may not be clear. A walk-on player at one school may be a scholarship player at another. Limiting the number of scholarships may prevent some wealthier schools from stockpiling players. On the other hand, walk-on players who excel are often subsequently awarded scholarships, and a school would have little interest in stockpiling those who do not excel. Thus it is not clear what the ultimate damage to competition in the sports entertainment market would be.

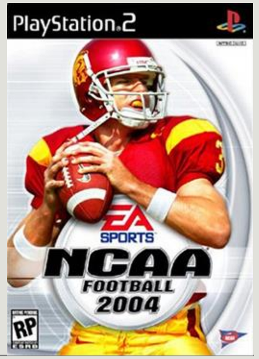
These questions were not addressed because the NCAA was able to prevail with an argument the class of plaintiffs should not be certified (see the book). Although the court did not certify the class, the underlying antitrust issue remains undecided.

White v. NCAA

In White v. NCAA, the issue was not the number of scholarships but the amount paid per scholarship to football and basketball players since February 2002. Plaintiffs claimed that collusion among NCAA members led to a grant-in-aid cap that was less than the actual costs of attending college.

A judicial decision on whether the cap violated the antitrust laws was avoided. The result was a settlement between the NCAA and the class. The NCAA agreed to make available a fund totaling $218 million for the purpose of aiding student-athletes with “demonstrated financial and/or academic needs.” In addition, a $10 million fund was established to reimburse former players for a variety of expenses to be incurred in the future in connection with career development.

O’Bannon v. NCAA



Student athletes agree to surrender their property rights in their own images. These property rights are not worth much for most players, however, for the elite few, these rights may be worth a good deals.

Another NCAA regulation permits the use of an athlete’s likeness, picture, or name in school and conference promotions, but all money goes directly to the school or conference. If the athlete receives any compensation, he or she jeopardizes his or her eligibility.

Ed O’Bannon, a former UCLA basketball player, filed a suit against the NCAA. The suit argued that after graduation, a former student athlete should become entitled to financial compensation for NCAA’s commercial uses of his/her image. The Ninth circuit judged in favor of O’Bannon finding that the NCAA committed antitrust violations. The court however ruled that the NCAA only had to provide up to the cost of attendance to their student athletes. The case was brought to the supreme court, but the supreme court denied to hear it.