

PUBLIC SPORTS SUPPLY

CRITICAL ANALYSES OF PROFESSIONAL AND TOP-LEVEL SPORTS FINANCING ACCORDING
TO ECONOMIC EFFICIENCY THEORY

José Viseu

Cláudia Ribeiro

Sports Observatory

Economic Policies Research Unit – Minho University, Portugal

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J. Viseu and **C. Ribeiro**, Sports Observatory, Economic Policies Research Unit – Minho University, Portugal

Abstract

This paper aims to discuss the public financing of professional and top-level sport at a normative economics level. Financial sport resources are always scarce. They must be evaluated in terms of their allocation for the best possible alternative. This way of planning takes into account the opportunity costs of sports finance.

From the economic theory point of view, public subsidies to professional sports have to be analyzed carefully. Economics (also) care about the efficiency e justice of goods distribution. Therefore, the development of rules and rational recommendations to allocate scarce resources in alternative goods and services (*allocation function*) as well as normative postulates for the distribution of income and wealth among social classes (*distribution function*), is one important matter to considerate in modern approach of Sports Economics.

This rational way of looking to our society's social challenges and problems is extremely important when common well fair is questioned.

Introduction

When applying economic efficiency to public financing of top-level and elite sports, we can state that: *Who finances sport should be able to collect its benefits*. That means: those who are responsible for covering the costs have the legitimate right to participate in the profits – said in another way: the individuals profiting from sports should be responsible for its overheads. In economic theory we speak about internalizing all (!) relevant economic outcomes of a given activity.

This logical thinking has one strong assumption to be settled in the beginnings: we are perfectly able to identify who finances and who benefits from sport spectacle. One important market failure of public financing of professional and top-performance sports is created by the dichotomous experience of public and private hands interaction: the first focusing on the individual and the second focusing on the money-making market. Both have a social and a collective target approach as well as a political target approach. Only the profit outcome is different: public investments target on the citizens' quality of life profit and private investments target on the enterprises' profit.

1. PUBLIC GOODS THEORY

Markets and governments are different ways to organize economic activities. Markets allow agents to exchange goods and services through money and at a given price. Governments grant law and order as well as provide goods and services (the so called “public goods”) in exchange of taxes. Both differ by the type of property rights involved and the outcome that each produces. The best way to organize economic activity will depend on the characteristics of the goods/services in question.

Goods are classified according to the nature of their consumption benefits. There are goods from which it is difficult or costly to exclude consumers. If this is the case, we talk about **non-excludability**, which means that it is not possible (or not profitable) to exclude non-payers once it is made available to anyone. One classical example is national security: once governments invest in it, single individuals can't be excluded from its benefiting.

Another important characteristic of public goods is the property of **non-rivalry**, which means that the use of the good/service by some consumers does not diminish its available amount to other consumers. That is, we can always include more consumers without reducing the utility level of the previous consumers. The classical example here is TV programming consumption.

So we can summarize these characteristics in the following table:

	rivalry in consumption	non-rivalry in consumption
Excludable	PRIVATE GOODS	TRADE GOODS
non-excludable	COMMON GOODS	PUBLIC GOODS

Goods which are rivalrous and excludable in its consumption are called private goods (f.i. a car). Goods which are rivalrous and non-excludable in its consumption are called common goods, like sea fishing. If we are in the presence of a non-rivalrous consumption type and we can exclude through a given price those consumers that can't

or don't want to pay, we are in the presence of tool goods. If goods are non-rivalry and non-excludable in its consumption, they are public goods.

As defined by Samuelson (1954), there are two main properties which difference public from private goods: public goods are non-excludable and non-rivalry in consumption, while private goods are sold only to those who can afford to pay the given price. The market prices exclude consumers. The property of rivalry consumption ensures that not all consumers who can afford to pay the price actually purchase the private good.

Nevertheless, the classification of goods isn't easy and "pure" public goods are hard to identify. Lets take the case of a government deciding to invest more in one specific type of public health (say child care) as an example. Given the same budget restrictions, this diminishes the investment in other public health areas. There is almost always some rivalry and excludability in consumption. Subsequently, while "pure" public goods are hard to find, there a lot of goods wich have public goods elements.

These definitions of goods have an enourmous importance as, depending on the goods characteristics upon the market, we may determine if its private supply is more or less efficient than its public one. If the good is a private good, the market will allocate efficiently the necessary resources and will produce it according to what is socially efficient. Price mechanism will reflect automatically the costs of the producer and the bennefits to the consumers. If the good is a public good, as individuals may bennefit from it without paying, the same mechanism will not work, in other words, there will emerge problems of "free-riding".

1.2. Market Failure

Market transactions occur voluntarily. It is understood that when they take place, the agents involved are better off and so, competitive markets promote automatically efficiency in resource allocation. However, this does not always happens. This would only be true if there weren't any market failures. The properties of public goods are by themselves sources of market failures.

The property of non-rivalry implies that the price to pay doesn't exclude any of the consumers that want to buy the good. This should bring up individual prices adjusted to each consumer financial possibilities and utility functions in order to allow that each one obtains net benefits from consumption. In practice this becomes impossible to settle when we are in the presence of a large number of consumers.

If a good is non-excludable, the individual has no incentive to pay for the supply of the good, as he won't be prevented from enjoying it. If all the individuals assume this behavior, none will voluntarily contribute to its production costs. That is, the consumers, because of the impossibility of exclusion, will rationally behave in a way that may be considered anti-social, appropriating benefits without contributing to their financing. In other words: they are invited to "free-ride".

In general terms, we state that one important source of market failure is the presence of externalities. If a perfectly competitive market exists, it will result in a "pareto" optimal allocation of resources (by other words: it will be impossible to improve the welfare of one individual without harming the welfare of another).

In a lot of cases we observe a great difference between social and private costs in good supply: an externality occurs (leading to the misslocation of resources). When the action of one agent affects negatively the welfare of one other and this negative effect isn't internalized by the producer – f.i. including it in the market price of the produced good –, we speak about negative externalities. One classic example of a negative externality is the air pollution through industrial production processes.

The existence of externalities justifies, in certain ways, government intervention, trying to correct environmental harming market failures. The correction instruments of governments are usually (i) taxes, if the externality is negative, (ii) subsidies, if the externality is positive, (iii) legal regulation and (iv) good production.

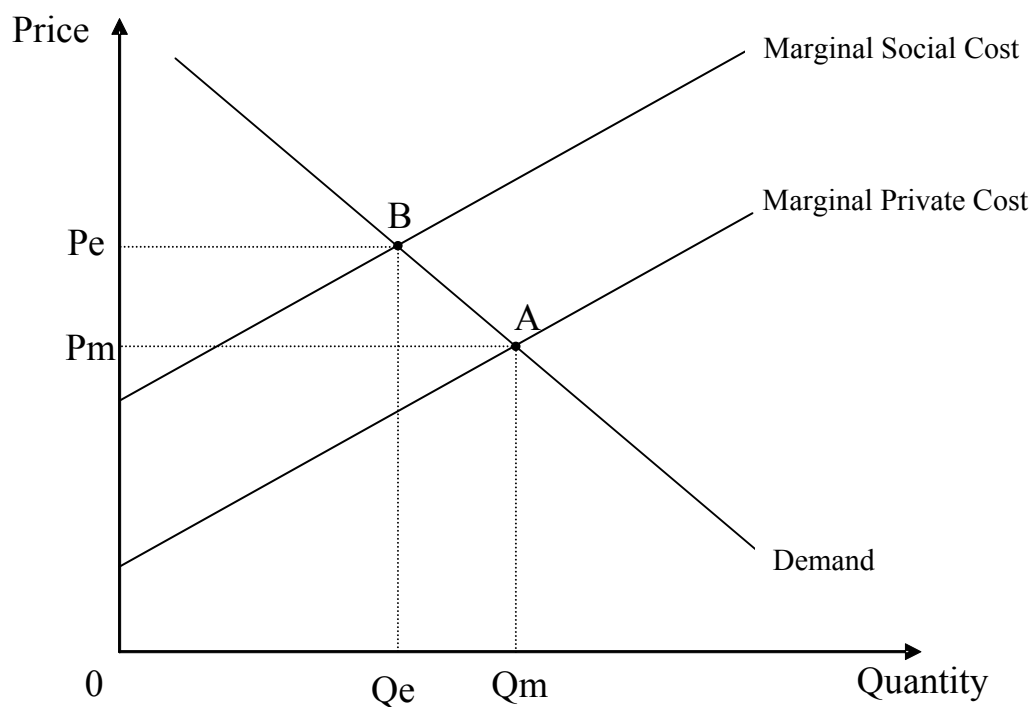
Within the public finance literature, public goods are closely related to externalities, since Mishan (1971) and Evans (1970) established that externalities consumption can be

analyzed as a public good. Though, the role of externalities in public goods supply cannot be overlooked.

The difference between a pure public good and an externality is that in the case of a public good all members of the community consume the same good, whereas in the presence of an externality, the good consumed by some parties may differ from the others, depending on the “consumption interpretation” of each party. In the private economy, this effect would be fully accomplished by the price system.

The external effects can be positive or negative. The positive effects happens when the activity causes benefits to others producers or consumers. Accordingly, the contrary occurs when we talk about negative effects.

Pigou (1920) suggested that the intervention of the government was necessary to correct for externalities by imposing taxes and by offering subsidies. We can see f. i., the example of a negative externality which produces at market equilibrium which is the quantity Q_m .



In the absence of externalities, this would occur when marginal private cost, equal to social marginal cost, intersects the demand curve, equal to the marginal social benefit (see point “A” at the previous graph).

If there is a negative externality, the supply curve will not reflect marginal social cost, but only private marginal cost, because there will be some costs that the producer doesn't internalize. Efficiency rules require that marginal social cost equals marginal social benefit (that would occur at “Q_e”). Government should intervene by forcing companies to pay all the costs of their production, taxing an amount corresponding to the difference between social and private marginal costs, that is, the value corresponding to the distance between “P_e” and “P_m” on the graph.

Subsidies will work the other way around and induce good production.

Coase (1960) changed this view of the role of the governments in the presence of externalities. Coase argued that the existence of externalities did not require inevitably government intervention through taxes or subsidies. In his work, Coase develops the *Theorem 9.1* which states that:

In the absence of transaction costs and bargaining costs, affected parties to an externality would agree on an allocation of resources that is both Pareto optimal and independent of any prior assignment property rights, ...

which means that, in some situations, citizens may solve their supply problems independently of government nosing. That is, government intervention isn't the only way to deal with market failure. Private collective action may occur. In physical leisure activity, for instance, local residents may join themselves to warrant their own specific facilities supply. So at the end, the justification for government involvement is that the costs for the private sector to produce those public goods/services are too high.

PUBLIC GOODS THEORY APPLIED TO SPORTS

Top-level sport is private initiative driven. Rules are defined and organizations are established. Private associations and federations organize this sport. They do not need governmental intervention to manage daily work agenda. According to the criteria of economic theory, we have:

i) the production of top-level sport is clearly related to an positive benefit index, sometimes even highly positive, so it is possible to speak about **consumption rivalry**, as f.i. there is only one olympic gold medal for each sport. Another example is that european soccer clubs – aiming economic survival – need to compete at the UEFA Cup and Champions League levels, so they must finish national championships within a certain ranking,

ii) consumers may be excluded of the consumption of top-level sports events through gate money and pay-TV fees, in the case they do not want to pay the given price, so it is possible to speak about **consumption segregation**;

iii) there is an associated financial **resource scarceness** and

iv) top-level sports (f.i. in the sense of TV rights) is perfectly **divisible** and **individually attributable**.

It is easily deductible that the pure market economy tends to exclude sports or sports activities that are less attractive, in such a way that we would notice a market concentration of certain sports or sports activities that are more profitable. Rational reasoning in terms of social and political objectives or contribute to a balanced international recognition of a modern country are put behind.

An international positive image of a country is attained when Public and Private work together. In this case, we might even speak about merit contributions from the private economy in the sense of a social and political normative wish. Government wishes to polish the country's image by showing a competitive, productive and young national team. Private hand assures supply of some profitable sports.

This is a national interest.

But, this shared goal has nothing to do with the pure market economy driven efficiency. Public supply of sports should focus on the distribution of the good “sport”. Equal opportunities for all sports and sports activities are the most important. Private supply is only focused on specific talents and more and more profitable competitions.

The political party that stimulates and grants this “private sport”, even though it is already supplied by the market economy, has to convince voters that this interpretation of social well fare of sports is in the very best interest of the population. In the majority of the cases, the political representatives use the argument of the production of common goods – allegedly highly valued and socially esteemed – and avoid mentioning that these goods have to be paid by tax money. A purely economic analysis of this problem – which has to announce alternative costs at given scarceness – would never accept this way of procedure. On the other hand, the political analysis is satisfied with democratic legitimacy: party policies are validated when a party is reelected. It does not matter if they were right or wrong at the sport economic efficiency level.

2. PUBLIC FINANCING OF PROFESSIONAL AND TOP-LEVEL SPORTS

The external effects of sports can be negative or positive: if they are negative, it is necessary to confine its market production and distribution; if they are positive, it is highly recommendable that its production and distribution is pushed. In the case of professional and top-level sports we can argue as follows:

i) the economic activity produces desirable social and political effects (positive foreign image of one's country and integration in the international community) and

ii) the economic activity has a model character for a specific sport or sport activity in general – in this situation the social meanings of sports determine the external effect; at this level we use to broadcast the positive side effects of sport over human qualities as f.i. performance, resistance, discipline, justice, rules, ...¹

A model character can be found f.i. when baseball youth teams are trying to reach superior performance in order to achieve their sport heroes magic strike and, on another basis, when an international firm is pushing sponsoring for the national team, they are also ensuring and reinforcing this model character for general market consumption.

In the cases where we can identify positive external effects for the population and the private economy does support its production, the criteria of economic efficiency demands public participation translated into direct or indirect tangible public subventions, like those associated to the financial incentives: f.i. reduced tax, operational subsidies, ... The question is not as much related with Government's involvement in professional and top-level sports, but with the explanation and deduction of the public sport administration intervention through subsidies for public sport welfare. ***How, where, when and why should we subsidy professional and top-level sports?***

¹ But we need to look at this in a critical manner. It is not certain that a positive correlation factor can be found between the model character of sports and some positive side effect. As well, if we take public health as an example, professional and top-level sports have some of the highest injuries incidence rate when compared to other economic activities.

We should keep in mind that the private sector related to professional and top-level sports is (1) highly interested in keeping its economic activity over time, (2) positive external effects may not be as “big” to justify public involvement and (3) positive external effects might not even occur.²

Thus, we don't have any reason to assume that the public financing of all professional and top-level sports must be subjected to the same rules. The only common fact to all is related with the need to create and maintain public order, without the Government having to interfere with the sports financing process of profitable sports.

This reasoning is only true, if all effects of professional and top-level sports – including all negative side effects – are converted to tangible market prices. And this is impossible to carry out. The same happens with external effects that are charged to others, not involved in the economic sport process; in this case it is impossible to reach global efficiency supported through a market economy procedure.

Looking at the sports financing from the human resources point of view, the production function of professional and top-level sports is specific as it implies normally a long investment on human resources and capital factors. This investment is linked to a high level of refinancing risks. Individual private investment in a sports career is not rational. When we look once again at professional and top-level sport from its private character point of view, we find that access costs to the market are extremely high, because these athletes do not only need high wages, as their preparatory career for higher sport performances represents an enormous time cost that could be allocated to other productive and profitable activities.

We can state that a top-level performance cannot be fulfilled only at one's free or leisure time. The scarce source 'time' that is left is used to work and attend school. Athletes are conscientiously giving away income. If the risk to access the sport market is extremely high, the lost of income is not covered by the latter commerce of one's own sport performance. The costs to access the market are equal to lost costs: the sunk costs. This means, one person lowers total individual lifetime income. In this sense, social and

² The organization of an international sport event is mainly associated to positive impacts of the country's image.

political arguments are pushed again, stating that different socio-economic conditions of the households may induce those with lower wages not to invest in sporting excellence. If this reasoning is right, it is – after all – necessary to assure the access to the top-level sports market to potential sport talents through public subsidies.

In all cases we need to maintain one line of argument: if public money has been used to permit sports market access to lower prices, then individual private sports commerce must not be allowed, because otherwise we are not following the principle of economic efficiency: profits should revert to all those who made the business possible through its financing.

All these thoughts could be simplified if, for instance, public financing of professional and top-level sports would be made through a loan. The loan would automatically be amortized in the way sport success would be followed by economic success. In those cases where economic success stays away – and it does not matter if the sport marks haven't been reached in that sport activity or commerce does not follow success – the distribution of the respective costs to all tax payers is a question of basic social justice.

This total sharing of profits and costs system – f.i. refundable scholarships – demands political rules and strategies that control all the possible tax evasion and fraud.

It is much more exiting to open the way of sport excellence and success through financing sports for all, than through financing sporting excellence only. Said in another way: there is a strong relation between top-level sport and sport-for-all. Scouting of young talents mainly happens at the sports-for-all level. But, the reasoning of this paper may not be transferred to the sports-for-all situation. The financing of sport – as a whole phenomenon – depends on other laws and principles than those of the top-level sports. Reflections of scientific modeling and economic theory must be adapted and transferred correctly to the institutional platform and social organization theory.

3. FINAL REMARKS

To conclude: we should have as much market as possible and as much Government as strictly necessary to allow market efficiency through prices and, at the same time, to assure politically equity of opportunities in a natural equilibrium. To choose only one way does not seem to be the right “line of attack”. One of the possible ways to solve this in the field is the development of public-private partnership, avoiding the worse case scenarios – the public-private competition.

The percentage of private refinancing of professional and top-level sports has grown thanks to Sponsoring – having nothing to do with patronage –, enlarging commerce of sports success and incorporating continuously new economic impulses from media. This has not to be necessarily negative. It represents the consequence of a new and ever changing civilization that develops news consumption patterns. Sport aiming maximum success is part of this culture. In those cases where sports profit from private economy, we should not criticize the danger of commerce of sports. The reduction of public financing to sports – taking into account socio-political objectives are secured through private hand – means simultaneously governmental resources are freed for other social interventions.

The public financing of professional and top-level sports compete with other public objectives. As larger we allow private intervention, as better governmental intervention can be at other levels of economic policy in social sports.

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