

Testimony
Of
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Domestic Policy Subcommittee
Oversight and Government Reform Committee

“Subsidization of Professional Sports Facility Construction”
Thursday, September 18th, 2008
2154 Rayburn House Office Building
10:00 a.m.

Chairman Kucinich, Ranking Member Issa and other members of the subcommittee:

In 2006, the Internal Revenue Service issued two Private Letter Rulings that enabled the New Yankees Stadium construction project in New York City to be financed by a tax exempt bond offering backed by payments in lieu of taxes (PILOTS). This ruling effectively allowed the Yankees access to low interest tax exempt bonds, as opposed to privately issued taxable bonds that carry a higher interest rate, to finance the construction of a privately owned sports facility. This ruling opened the floodgates to a subsequent wave of PILOT backed tax exempt bonds for the construction of new sports facilities that shows no signs of slowing. The Yankee PILOT decision raises several important economic policy issues that must be addressed if the Congress is to make and enforce appropriate economic policy about the financing of professional sports facilities.

MLB’s Anti-Trust Exemption, Franchise Moves, and Public Subsidies

Before focusing on the details of the PILOT issue, I want to put the general topic of public financing of professional baseball stadiums into the broader context of federal government policy toward the professional sports industry in the United States. In particular, I want to draw attention to the fact that the financing of both new baseball stadiums in New York City was influenced by threats made by both the New York Yankees and New York Mets to leave the city of New York. In a memorandum from Andrew M. Alper to New York City Mayor Michael Bloomberg explaining why the Yankees were granted an exemption from the New York City Industrial Development Agency (NYCIDA) policy, then director Alper stated that failure to give the Yankees what they wanted would “result in the New York Yankees relocating the Team to a stadium outside the

City.”¹ In another memorandum from Alper to New York City Mayor Michael Bloomberg explaining why the Mets were granted a similar exemption from the NYCIDA policy, Alper stated that failure to give the Mets what they wanted would “result in the New York Mets relocating the Team to a stadium outside the City of New York.”²

Based on two memorandums from the NYCIDA, both professional baseball teams in New York City used the threat of leaving to extract concessions from the City of New York. Economic theory provides a clear explanation for why professional baseball teams have this power: they have significant market power and can operate as unregulated monopolies. Unlike most other industries in the United States, Major League Baseball (MLB) receives special treatment under federal anti-trust law. This special treatment has been extended by the Congress of the United States. In practice, the anti-trust exemption granted to MLB by Congress means that there are fewer MLB franchises than would exist if MLB were not granted this special status. Economic theory predicts that monopolies restrict output in order to realize monopoly rents. In the case of MLB, monopoly power is exercised by limiting the total number of teams in each league. In this specific case, it means that the Yankees and Mets were able to force state and local governments to grant them special benefits not available to other firms because of the anti-trust exemption granted by Congress. If MLB did not have this special protection, it is possible that the Yankees and Mets would not have had another viable alternative market to threaten to move into. The explicit justification for the deviation granted to both the Yankees and Mets stadiums was a threat to move. The ultimate cause of the New York PILOT mess is MLB’s anti-trust exemption.

The Relationship between Ticket Prices and New Facilities in MLB

Major League Baseball teams produce a product that has only a few imperfect substitutes in the local economy. Unlike many other firms, MLB teams face little competition in the marketplace. This gives MLB teams significant latitude when setting prices. In most cases, when firms set their prices at a level “that the market will bear” they face significant price competition from other firms that limits their ability to raise prices. A business with many competitors cannot raise prices too much because their customers will turn to other producers. MLB teams do not face this type of competition. Their product has few close substitutes, so they can set prices based only on the market demand for their product. In large markets, like New York City, this market demand can be quite large compared to the number of tickets sold in any season. The only constraint on price increases faced by professional sports teams is the willingness of fans to pay in sufficient numbers.

Professional baseball teams offer tickets for sale at a wide variety of prices. Although the cost of attending a MLB game is often expressed in terms of an “average” or “median” ticket price, this simplification abstracts from actual choices facing consumers. An examination of the pricing policies of MLB teams from 1975 through 2006 reveals that, on average, MLB teams offered tickets at about six different price levels, with a maximum of fifteen different ticket price levels offered by a single team. In part, these differences in ticket prices reflect differences in the experience of fans:

¹ New York City Industrial Development Agency memorandum “Deviation from Uniform Tax Exemption Policy for Yankees Ballpark Company.”

² New York City Industrial Development Agency memorandum “Deviation from Uniform Tax Exemption Policy for Queens Ballpark. L.L.C..”

a fan sitting in the first row behind home plate experiences the game in a different way than a fan sitting in the last row of the upper deck. Fans are willing to pay more for the experience of sitting in the first row behind home plate than they are for the experience of sitting in the last row of the upper deck. The large number of different prices offered by MLB teams means that they have many options available to them when changing prices. It also means that changes in the average or median price of a ticket may not reflect changes in ticket prices across the board.

Over the period 1975-2006, the average annual increase in the average ticket price charged by MLB teams playing in the same stadium as the previous season was 7.72%. The average annual increase in the median ticket price was 7.60%, a similar change. Because MLB teams offer tickets at many different prices, the change in the average or median ticket price may not reflect the overall pattern of ticket price changes from year to year. An alternative way of looking at price changes is to examine how the highest priced tickets and lowest priced tickets change. The average annual increase in the highest priced ticket offered by MLB teams playing in the same stadium over the period 1975-2006 was 9.17%. The average annual increase in the lowest priced ticket offered by MLB teams over this period was 9.27%. Teams playing in existing stadiums tend to raise the price of tickets at the upper and lower end of the price range more than tickets in the middle of this range. These annual price increases are not adjusted for inflation, for reasons that will be explained shortly. All of the relative price increases discussed here would be unchanged if corrected for increases in the overall price level.

MLB teams playing in new stadiums have, on average, increased their prices at a higher annual rate than teams playing in an existing stadium. The average annual increase in the average ticket price charged by an MLB team playing in a new stadium over the period 1975-2006 was 19.56%; the average increase in the median ticket price was 14.32%. There were 16 new baseball stadiums opened during this period. In part, these ticket price increases reflect a different experience for fans in a new stadium, but they also depend on the market power of MLB teams. The increases at the top and bottom of the price range charged by MLB teams differed from the changes in the average or median prices. The average annual increase in the highest ticket price offered by MLB teams playing in a new stadium was 32.23%. The average increase in the lowest priced ticket offered was 8.70%. High end tickets tend to see the biggest price increases when a team moves into a new stadium in MLB.

The increase in ticket prices announced by the New York Yankees in their new stadium has drawn a great deal of attention. The MLB wide averages reported above provide some perspective on the Yankees' announced price increases. In the 2008 season, the Yankees offered season tickets at 15 different prices, ranging from \$12 per game for a full season ticket in the bleachers to \$325 per game for a full season ticket in the "Field Championship" section. The average price of a season ticket to the Yankees was \$106, and the median price was \$70. The price of Yankees' season tickets in the new stadium in 2009 will range from \$2500 per game for a full season ticket in the "legends" section to \$12 per game for a full season ticket in the bleachers.³ This represents a 139% annual change in the average price of a Yankees ticket, and a stunning 669% annual increase in the price of the highest ticket price offered. No MLB team moving into a new stadium has increased the top ticket price offered by this amount in the past 33 years. This 669% increase is 20 times larger than the average annual increase in the highest ticket price offered by MLB teams moving

³ *Relocation Program Guide for the New Yankee Stadium*, Yankees.mlb.com.

into a new stadium, and more than three times larger than the next largest annual increase in the highest ticket price offered (the Detroit Tigers increased their highest ticket price by 200% when they moved into their new stadium in 2000.)⁴

The average increase in the median price of a Yankees ticket from 2008 to 2009 was 7%, and the per game price of a season ticket for the bleachers remains unchanged at \$12 per game in the new stadium. Although the team has heralded this as evidence that the “average fan” would not be priced out of the new stadium, at this time the price of game day bleacher tickets has not been announced, only full season ticket prices. While there has been no change in the per game price paid by fans who purchase 81 bleacher tickets in advance, it remains to be seen how much a game day bleacher ticket (a better indicator of how much the “average fan” will have to pay) will cost in the new stadium.

How PILOTs Differ from other Stadium Financing Schemes

The PILOT decision has resulted in a financing deal for the new Yankee Stadium that differs in important ways from the way that other new professional sports facilities have been financed in the post 1986 Tax Reform Act era. Two examples make these differences clear. Nationals Park opened in Washington, DC on May 4th 2006. The stadium cost \$610 million and was financed through the sale of tax exempt bonds issued by the city of Washington. Because tax exempt bonds were used to finance this stadium, the DC government had to raise taxes in order to pay the principal and interest on these bonds; these payments must come out of general tax revenues to comply with the Tax Reform Act of 1986. The requirement that the principal and interest on tax exempt bonds used to finance professional sports facility construction represents an important limit on the use of tax exempt bonds for this purpose, as well as a limit on construction costs. Local politicians are held accountable for the condition of their budgets by voters, and paying the principal and interest on these bonds out of general tax revenues has budgetary effects. Because general tax revenues are collected from a broader group of local residents than the sports fans that enjoy the benefits of a new stadium, this requirement reduces the amount of money spent on new sports facilities financed using tax exempt bonds, and may reduce construction costs as well.

AT&T Park, home of the San Francisco Giants, opened on March 31st, 2000. The stadium cost \$357 million to build (\$426 million in 2007 dollars) and was privately financed. No tax exempt bonds were issued to pay for the facility construction. The team had to pay a higher interest rate on the borrowed money than they would have if they had access to tax exempt financing, making the construction project more costly. The annual increase in the average price of a ticket offered by the Giants in 2000 was 21.3%; the annual increase in the highest priced ticket offered by the Giants was 9.52%, and the increase in the lowest price ticket offered was 66.6%.

Clearly, the PILOT decision has had a profound effect on the Yankee Stadium construction project. The access to lower interest rates offered by tax exempt funding, coupled with the lack of budgetary-related limits on costs combine to produce the most expensive stadium construction project in the history of Major League Baseball. And in part because of the lavish nature of the new stadium, the Yankees are able to pass on extraordinary ticket price increases to their fans.

⁴ Note that I compare the increase in the nominal price of Yankees tickets to the increase in the nominal price of other tickets because we do not yet know what the inflation rate will be between now and April 2009.

The Fallacy of New Job Creation in Sports Facility Construction

In reviewing documents related to the PILOT decision, one clear theme emerges: the primary economic rationale for the decision was that the new Yankee Stadium would be a significant engine of economic growth in New York City, and that this alleged economic benefit was sufficient justification for granting this exceptional privilege. In particular, the supporting documents point again and again to job creation associated with both the construction of the new stadium and the ongoing operation of the stadium as the primary justification for the decision.

These claims of significant economic benefits from sports stadium construction and operation are problematic for several reasons. First, they are forecasts, and not actual counts of jobs created or income earned. In the PILOT issue, and every other sports facility construction project I have studied, these forecasts of economic benefits are treated as factual assessments, rather than the forecasts that they are. Forecasts are not useful unless they contain a measure of the uncertainty associated with them, and the claimed future economic benefits from the new Yankee Stadium are never placed in this context. This makes them useless for informing economic policy decisions. The problem has already surfaced in the Yankee Stadium PILOT decision, as the claims of thousands of full time jobs made at the time the exemption was granted has already proven to be wildly overstated. Any additional claims of future economic benefits from the project should be taken with a grain of salt.

Second, there is no evidence in the large body of peer reviewed scholarly research on the economic impact of professional sports facilities that indicates any professional sports facility construction project, or the ongoing operation of any such facility has generated any tangible economic benefits in the local economy.⁵ In fact, economists widely agree on this point, and it is backed up by decades of evidence based on peer reviewed research. Even if the New Yankee Stadium is the most expensive stadium construction project in history, it will likely not generate any significant economic benefits in New York City.

Claimed benefits from the construction jobs created during stadium construction projects are one of the most abused claims of tangible economic benefits made by those seeking subsidies, because they are so evident. One has to simply drive by the construction site and see it swarming with workers to confirm these claims of economic benefits in the community. However, there is more to this situation than meets the eye. The key to determining the actual net economic benefits generated by sports stadium construction projects is to determine how many jobs are created that would not have existed if the project did not take place, and also to determine how many of the workers filling those jobs would have been unemployed if the project had not taken place. According to economic theory, only this small subset of the total number of jobs created by a stadium construction project can be counted as part of the economic impact of the project. Calculating this number cannot be accomplished by a simple inspection of the construction sight, and assuming that every worker observed on the job site represents new economic benefit to the local economy is erroneous.

⁵ See Dennis Coates and Brad R. Humphreys, "Do Economists Reach a Conclusion on Subsidies for Sports Franchises, Stadiums, and Mega-Events?" *Econ Journal Watch*, vol. 5, no. 3 (September 2008), pp. 294-315 for recent evidence on this point.

The net economic benefit created by stadium construction projects is much smaller than the total economic benefit (which can be easily found by simply adding up the total amount of spending associated with the project) because of the presence of opportunity costs, and the double counting that typically takes place when non-economists attempt to estimate these benefits. Opportunity cost is the cost of forgone alternatives. In the case of the New Yankee Stadium, the facility generates significant opportunity costs for the City of New York and in the local community. The City could have issued a billion plus dollars of tax exempt bonds to finance any number of alternatives. The testimony of Seth Pinsky, president of the NYCIDA before the New York State Assembly on July 2nd of this year indicates that his agency receives hundreds of requests each year for public tax exempt funding for construction projects.⁶ The materials and supplies that are going into the construction of the new stadium could have been used on other construction projects. And most importantly, the construction workers employed on this project could have worked on other projects. Economic theory tells us that only those construction workers who would not have had a job if the stadium was not built can be counted as net economic benefit from the project. According to a recent Bureau of Labor Statistics press release, the unemployment rate for construction workers in August 2008 was 1.9%.⁷ This low unemployment rate means that the actual number of new construction jobs created by the New Yankee Stadium project was a tiny fraction of the total number of jobs created by the project.

Thank you for your time. I will now take your questions.

A handwritten signature in black ink that reads "Brad R. Humphreys". The signature is written in a cursive, flowing style.

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⁶ Transcript from July 2nd 2008 public hearing: The Request for Increased Public Financing for Construction of a New Yankee Stadium in New York City, hearing before the Assembly Standing Committee on Corporations, Authorities and Commissions.

⁷ <http://www.bls.gov/news.release/empsit.t11.htm>