

Case Studies

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Case Study 4.1: The Market for Professional Basketball

Toward the end of the 1970s, the NBA seemed on the brink of collapse. Attendance had sunk to little more than half the capacity. Some teams were nearly bankrupt. Championship games didn't even merit prime-time television coverage. But in the 1980s, three superstars turned things around. Michael Jordan, Larry Bird, and Magic Johnson created millions of fans and breathed new life into the sagging league. New generations of stars, including Dwayne Wade, Carmelo Anthony, and LeBron James, continue to fuel interest.

Since 1980 the league has expanded from 22 to 30 teams and game attendance has more than doubled. New franchises have sold for record amounts. More importantly, league revenue from broadcast rights jumped more than *40-fold* from \$19 million per year during the 1978–1982 contract to \$785 million per year during the 2002–2008 contract. Popularity also increased around the world as international players, such as Yao Ming of China and Dirk Nowitzki of Germany, joined the league (basketball is now the most widely played team sport in China). NBA rosters in 2007 included more than 70 international players. The NBA formed marketing alliances with global companies such as Coca-Cola and McDonald's, and league playoffs are now televised in more than 200 countries in 45 languages to a potential market of 3 billion people.

What's the key resource in the production of NBA games? Talented players. The exhibit below shows the market for NBA players, with demand and supply in 1980 as D_{1980} and S_{1980} . The intersection of these two curves generated an average pay in 1980 of \$170,000, or \$0.17 million, for the 300 or so players in the league. Since 1980, the talent pool expanded somewhat, shifting the supply curve a bit rightward from S_{1980} to S_{2007} (almost by definition, the supply of the top few hundred players in the world is limited). But demand exploded from D_{1980} to D_{2007} . With supply relatively fixed, the greater demand boosted average pay to \$4.9 million by 2007 for the 450 or so players in the league. Such pay attracts younger and younger players. Stars who entered the NBA right out of high school include Kobe Bryant, Kevin Garnett, and LeBron James. (After nine players entered the NBA draft right out of high school in 2005, the league, to stem the flow, required draft candidates to be at least 19 years old and out of high school one year.)

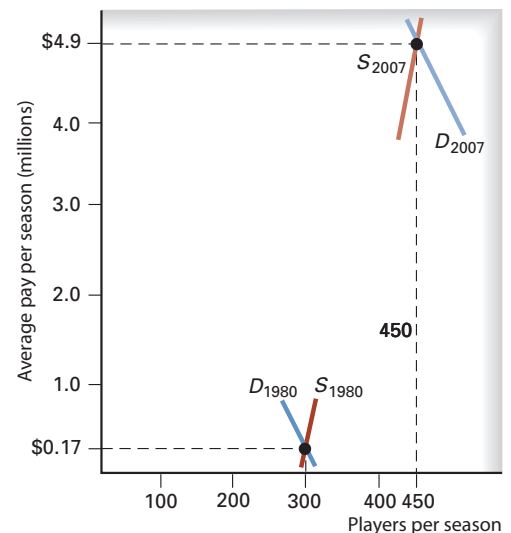
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NBA Pay Leaps

Because the supply of the world's top few hundred basketball players is relatively fixed by definition, the big jump in the demand for such talent caused average league pay to explode. Average pay increased from \$170,000 in 1980 to \$4,900,000 in 2007. Because the number of teams in the NBA increased, the number of players in the league grew from about 300 to about 450.

NBA Pay Leaps



But rare talent alone does not command high pay. Top rodeo riders, top bowlers, and top women basketball players also possess rare talent, but the demand for their talent is not sufficient to support pay anywhere near NBA levels. NBA players earn nearly 100 times more than WNBA players. For example, Diana Taurasi, a great college player, earned only \$40,800 her first pro season. Men earn more than women in all professional sports except in tennis, where prize money is the same. Some sports aren't even popular enough to support professional leagues (for example, the U.S. women's pro soccer league folded).

NBA players are now the highest-paid team athletes in the world—earning 60 percent more than pro baseball's average and at least double that of pro football and pro hockey. Both demand *and* supply determine average pay.

SOURCES: Krystyna Rudzki, "At Last—Equal Pay at Wimbledon," *South China Morning Post*, 23 February 2007; Michael Hall, "Kevin Durant, Shooting Star," *New York Times*, 4 March 2007; Brian Straus, "Women's Pro Soccer League Forced to Fold," *Washington Post*, 16 September 2003; and U.S. Census Bureau, *Statistical Abstract of the United States: 2007*, <http://www.census.gov/prod/www/statistical-abstract.html>

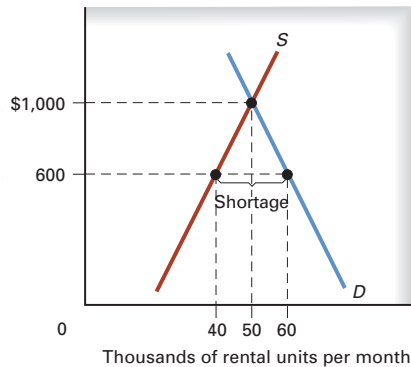
QUESTION

1. In what sense can we speak of a market for professional basketball? Who are the demanders and who are the suppliers? What are some examples of how changes in supply or demand conditions have affected this market?

Case Study 4.2: Rent Ceilings in New York City

New York City rent controls began after World War II, when greater demand for rental housing threatened to push rents higher. To keep prices from rising to their equilibrium level, city officials imposed rent ceilings. Since the quantity demanded at the ceiling price exceeded the quantity supplied, a housing shortage resulted, as was sketched out in the exhibit below. Thus, the perverse response to a tight housing market was a policy that reduced the supply of housing over time.

Price Ceilings for Rent



Prior to rent controls, builders in New York City completed about 30,000 housing units a year and 90,000 units in the peak year. After rent controls, new construction dropped sharply. To stimulate supply, the city periodically promised rent-ceiling exemptions for new construction. But three times the city broke that promise after the housing was built. So builders remain understandably wary. During the peak year of the last decade only about 10,000 new housing units were built.

The excess demand for housing in the rent-controlled sector spilled into the free-market sector, increasing demand there. This greater demand raised rents in the free-market sector, making a rent-controlled apartment that much more attractive. New York City rent regulations now cover half the 2.1 million rental apartments in the city.

Tenants in rent-controlled apartments are entitled to stay until they die, and with a little planning, they can pass along the apartment to their heirs. Rent control forces tenants into housing choices they would not otherwise make. After the kids have grown and one spouse has died, the last parent standing usually remains in an apartment too big for one person but too much of a bargain to give up. An heir will often stay for the same reason. Some people keep rent-controlled apartments as weekend retreats for decades after they have moved from New York. All this wastes valuable resources and worsens the housing shortage.

Since there is excess quantity demanded for rent-controlled apartments, landlords have less incentive to keep apartments in good shape. A survey found that about 30 percent of rent-controlled housing in the United States was deteriorating versus only 8 percent of free-market housing. Similar results have been found for England and France. Sometimes the rent is so low that owners simply abandon their property. During one decade, owners abandoned a third of a million units in New York City. So rent controls reduce not only the quantity but the quality of housing available.

You would think that rent control benefits the poor most, but it hasn't worked out that way. Henry Pollakowski, an MIT housing economist, concludes that tenants in low- and moderate-income areas get little or no benefit from rent control. But rich people living in a rent-controlled apartment in the nicest part of town get a windfall. Someone in upscale sections of Manhattan might pay only \$750 a month for a three-bedroom apartment that would rent for \$12,000 a month on the open market.

Once a tenant leaves a rent-controlled apartment, landlords can raise the rent on the next tenant and under some circumstances can escape rent controls entirely. With so much at stake, landlords under rent control have a strong incentive to oust a tenant. Some landlords have been known to pay \$5,000 bounties to doormen who report tenants violating their lease (for example, the place is not the tenant's primary residence or the tenant is illegally subletting). Landlords also hire private detectives to identify lease violators. And landlords use professional "facilitators" to negotiate with tenants about moving out. Many tenants end up getting paid hundreds of thousands of dollars for agreeing to move. Some get as much as \$2 million. Facilitators can often find tenants a better apartment in the free-market sector along with enough cash to cover the higher rent for, say, 10 years. Since the rental market is in disequilibrium, other markets, such as the market for buying out tenants, kick in.

SOURCES: Henry Pollakowski, "Who Really Benefits from New York City's Rent Regulation System?" *Civic Report* 34 (March 2003) at http://www.manhattan-institute.org/html/cr_34.htm; Janny Scott, "Illegal Sublets Put Private Eyes on the Cast," *New York Times*, 27 January 2007; David Segal, "Apartment 300 G," *Washington Post*, 2 May 2005; and Sue Shellenbarger, "Escape from New York," *Wall Street Journal*, 21 February 2007.

QUESTION

1. Suppose the demand and supply curves for rental housing units have the typical shapes and that the rental housing market is in equilibrium. Then, government establishes a rent ceiling below the equilibrium level.
 - a. What happens to the quantity of housing available?
 - b. What happens to the quality of housing and why?
 - c. Who benefits from rent control?
 - d. Who loses from rent control?
 - e. How do landlords of rent-controlled apartments try to get tenants to leave?