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Client Alert: Why it is 100x Riskier to Pay College Athletes than it is to Pay NFL Free Agents

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Every March, as the NCAA Final Four tips off, there is no shortage of opinions that it is madness to prohibit universities from paying college athletes cash compensation for the athletic services they provide.

But few if any of these opinions attempt to quantify the magnitude of the *risk* that paying college athletes cash would pose to intercollegiate athletics.

In 1956, Simon Rottenberg accurately articulated this risk in his paper, *The Baseball Players' Labor Market*. With an assist from Nobel Prize winning economist Gary S. Becker, Rottenberg observed the following about Major League Baseball during the era when the reserve clause—not free agency—was the defining financial rule of the game:

> It has been suggested … that, while major league players, and especially the star players of the major leagues, may be exploited, it does not follow that all players taken together are. The process by which players are brought to the major leagues can be likened to that by which paying oil wells are brought in or patentable inventions discovered. In all these cases there is heavy investment in the discovery of knowledge. When it is discovered, the returns are high, but these returns must compensate for the losses incurred on the attempts which failed. In this schematic conception minor-league players who do not qualify for major-league play are like dry wells and research which does not yield a patent.

The business of recruiting college athletes is structured like the patent system. When an inventor successfully applies for a patent, he or she trades inventive services for a time-limited monopoly to derive financial benefits from a patent. This cashless trade minimizes the risk to the public that the invention will prove economically unproductive after the patent is granted.

Similarly, a student-athlete that signs a National Letter of Intent (NLI) with a university trades his or her athletic services for the universities' educational services. This trade is a *trade of cost remittance* as each side agrees not to charge the other for the services provided. As in the patent system, this cashless trade

minimizes the risk to the public that the student-athlete will prove economically unproductive.

How much riskier would it be to pay college athletes cash for their athletic services than it is to pay professional athletes cash for their athletic services?

Each year over 160,000 student-athletes provide athletic services to a university pursuant to an NLI. In comparison, only a little over 1,600 players suit up on Sunday in the NFL, which just finished guaranteeing hundreds of millions of dollars to a handful of NFL players eligible for free agency. Both the college athletics recruiting market and the NFL free agency market require parties entering into agreements with athletes to judge the quality of the athletes prospectively. Thus, the risk of paying college athletes is about 100 times greater than the risk of paying NFL free agents.

But this is not the only risk to universities arising from the current model of recruiting and retaining college athletes.

Because the trade of cost remittance caps the liquid benefits available to student-athletes at $0 (remember, costs are negative numbers so $0 is a ceiling, not a floor), the trade appears to create costs of dishonesty that are rare in the NFL.

In *The Market for "Lemons": Quality, Uncertainty and the Market Mechanism*, Nobel Prize winning economist George Akerlof found that "dishonest dealings tend to drive honest dealings out of the market."

"The cost of dishonesty," Akerlof wrote, "lies not only in the amount by which the purchaser is cheated; the cost also must include the loss incurred from driving legitimate business out of existence."

A recent paper by Jill Harris, an Assistant Professor in the Department of Economics and Geosciences at the United States Air Force Academy, appears to corroborate that honest dealings in the recruiting market for college athletes are being driven out of the market by dishonest dealings. In *State of Play: How Do College Football Programs Compete for Student Athletes*, Professor Harris found that "data suggest cheating increases a college's share of the top 100 [recruits] by 725%. Winning bowl games increases the recruiting share by 94%."

Dishonesty driving honesty out of the market is a long-term risk to any sector of the economy subject to such a predicament.

The solution to this predicament, however, is unlikely to be found merely by abolishing the prohibition on paying college athletes cash compensation and subjecting the universities to the risk of potentially paying cash to more than 160,000 college student-athletes.

In order to *both* combat the risk of dishonesty driving honesty out of the recruiting market *and* to manage the risk of paying cash to more than 160,000 college student-athletes, more sophisticated hedging, and price discovery and risk management tools need to be developed.

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