

Homework Assignment #5: The Economics of Sports 229

_____Due: Wednesday, March 25

This assignment may be turned in as a group assignment. Up to a maximum of 5 names may be placed on the final paper turned in on Thursday. For this assignment, *and this assignment only*, each student is not required to turn in an independently written assignment. You are allowed to choose your own group of up to 5 people or work independently. Each person in the group will receive the same grade on the assignment.

1. a. Suppose a college junior basketball player could earn a salary of \$600,000 by declaring himself for the draft. If he waits until after his senior year, his salary will be \$700,000. If the discount rate is 7 percent and his NBA career will be one season long, should he stay or should he go now?
 - b. This question makes several critical errors in the analysis of the question. Name at least 3 other factors that should influence the decision to enter the draft early.
 - c. Now suppose a college junior basketball player could earn a salary of \$600,000 by declaring himself for the draft. If he waits until after his senior year, he has a 30% chance of getting injured or playing below expectations leading to the player not receiving an NBA contract. In this case his earnings are \$0. There is a 40% chance he will play as expected and receive a \$700,000 contract in the next year from the NBA. There is a 30% chance he will have an exceptional senior year which will raise his status in the NBA the next year leading to a \$1,000,000 salary. If the discount rate is 7 percent and his NBA career will be one season long, should he stay or should he go now?
 - d. Do college basketball players who leave college early or skip college entirely make a good decision? Explain.
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2. Suppose that in the case of *Wood v. NBA* (1987) that the NBA and the Players' Association did not have a current contract so that the nonstatutory labor exemption to the antitrust laws did not apply. Do you think that the amateur draft, right of first refusal, and revenue sharing/salary cap provisions would have survived scrutiny under the Rule of Reason? Explain.

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3. In 2000, Alex Rodriguez signed a record 10-year, \$252 million contract with the Texas Rangers. Excluding bonuses, the amount A-Rod was originally contracted to get in each year was:

2001 — \$18 million
2002 — \$19 million
2003 — \$20 million
2004 — \$20 million
2005 — \$23 million
2006 — \$21 million
2007 — \$23 million
2008 — \$24 million
2009 — \$24 million
2010 — \$24 million
2011 — \$6.72 million
2012 — \$5.38 million
2013 — \$4.03 million
2014 — \$4.03 million
2015 — \$5.38 million
2016 — \$5.38 million
2017 — \$5.38 million
2018 — \$4.03 million
2019 — \$4.03 million
2020 — \$4.03 million

The reason he gets payments beyond the end of the 10-year contract is because a portion of his salary is deferred. The total payments exceed \$252 million due to accrued interest.

- a. If the discount rate is 6.41% (the average return on 1-year Treasury Bills from 1984-2000), what was the net present value (NPV) in 2000 of A-Rod's record contract?
- b. If the discount rate is 8.71% (the average return on Aaa-rated corporate bonds from 1984-2000), what was the NPV in 2000 of the contract?
- c. If the discount rate is 17.12% (the average increase in professional athlete salaries from 1984-2000), what was the NPV in 2000 of the contract?
- d. List two reasons why the Rangers (and now the Evil Empire) would want to defer a portion of A-Rod's salary.
- e. Is A-Rod overpaid? What would you need to know to be able to adequately answer this question?