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Financial Fair Play in European Club Football –
What is it all about?

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**Financial Fair Play in European Club Football – What is it all about?**

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**Abstract**

The new UEFA Club Licensing and Financial Fair Play Regulations have encountered stiff criticism. The concerns are that the new regulations may harm football in three different ways: By forgoing the potential benefits from substantial injections of “external” money into payrolls, by restricting competition in the player market without at the same time achieving benefits from more balanced competition, and by creating some sort of barrier to entry which could “freeze” the current hierarchy of clubs. It is the purpose of this paper to take these concerns as a starting point for discussing the likely effects of the new regulations. As a by-product it will become obvious why and in which points the concerns are unfounded.

**Keywords**: Financial Fair Play, Soft Budget Constraints, Hard Budget Constraints, Moral Hazard, Rent-Seeking, Sugar Daddies, Competitive Balance, “Ossification”

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1 I was surprised by the “wave” of feedback, which I received in response to the first draft of this paper in a few weeks over the summer 2013. I would like to thank Wladimir Andreff, Brian Quinn, Umberto Lago, Paul Madden, Tim Pawlowski, Raphael Flepp, Markus Lang, Jan Pieper and Marc Brechot for their valued input. Jaume Garcia Villar invited me to Barcelona, where I had the opportunity to discuss the main arguments of this paper with Stefan Szymanski and Placido Rodriguez Guererro at a roundtable organized under the auspices of the Fundació Ernest Lluch. Petros Mavroidis and Miguel Poiares Maduro invited me to the European University Institute in Florence, where I had the chance to discuss some of the ideas presented in this paper in the context of the High-Level Policy Seminar “The Governance of European Football: Looking backwards, Looking forward”. The European Sport Economics Association (ESEA) invited me to the annual meeting 2013 in Esbjerg, where I had the honor to present this paper as keynote lecture. Paul Madden invited me to present my thoughts in the Special Session “The Economics of “Financial Fair Play” (FFP) in European Soccer” at the Annual Conference of The Royal Economic Society in Manchester 2014. I wish to thank the organizers and participants of these important events, knowing very well that not all of them share all my interpretations of Financial Fair Play.
1. INTRODUCTION

The new UEFA Club Licensing and Financial Fair Play Regulations (FFP regulations) are an enhancement of the Club Licensing System introduced at the start of the 2004/2005 football season (UEFA 2012). In order to be admitted to UEFA’s club competitions (Champions League and Europa League), each club must fulfill a series of defined quality standards falling into five principal categories: sporting, infrastructure, personnel, legal and financial. After elaborate consultation with the stakeholders of football (representatives of clubs, players, leagues and national associations), UEFA has used the implementation of the FFP regulations to introduce additional financial requirements that will be monitored by a newly created body of independent legal and financial experts, the Club Financial Control Body (CFCB).

The reason for agreeing to implement additional financial requirements was a shared perception that football clubs were sliding into an ever-deepening financial crisis that ultimately could threaten the long-term viability and sustainability of the entire system. Indeed, the financial results of the clubs competing in European competitions were worsening year after year despite the fact that football as an industry was booming. According to the UEFA Benchmarking Report for the financial year 2011², the revenues of European top division clubs had grown by an average yearly rate of 5.6% in the preceding five years to an impressive total of € 13.2 bn, while for example the average yearly growth rate of the whole economy in the Euro zone amounted to only 0.5%. Despite the strong growth in revenues, the aggregate net losses reported by the European top division clubs in the financial year 2011 added up to € 1.7 bn. Compared to the financial year 2007, aggregate net losses had almost tripled. An impressive 63% of European top-division clubs reported operating losses in the financial year 2011. The proportion of clubs, where auditors expressed concerns about whether the club could still trade normally in 12 months’ time, was 1 in 7. The percentage of clubs with negative net equity facing a situation with debts larger than reported assets amounted to 38%.

² See UEFA (2013) for the following numbers and very detailed additional information.
The introduction of the break-even requirement, which without any doubt is the cornerstone of the new regulations, needs to be interpreted against this background. This new rule, defined in Articles 58-63 (UEFA 2012), requests that clubs should live within their own means by and large. More precisely, clubs are in compliance with the break-even requirement if “relevant expenses” do not exceed “relevant income” in the reporting periods combined to one so called "monitoring period" by more than the “acceptable deviation” of € 5m. While there is some leeway at the beginning, allowing the “acceptable deviation” to exceed the “normal” level of € 5m up to a level of € 45m, provided that equity participants and/or related parties are willing to inject the respective funds, UEFA’s plan is to gradually reduce this “abnormal” injection in the longer run.

A closer look at the notions of relevant income and relevant expenses makes clear that benefactors can still inject unlimited sums of money into football clubs, for example by investing in stadia, youth academies or community projects, since such expenditures do not count as relevant expenses and therefore do not enter the break-even calculation. However, benefactors are no longer able to rescue a club for licensing purposes if the latter overinvested

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3 Article 58 (2) clarifies the notion of relevant expenses as follows: “Relevant expenses is defined as cost of sales, employee benefits expenses and other operating expenses, plus either amortisation or costs of acquiring player registrations, finance costs and dividends. It does not include depreciation/impairment of tangible fixed assets, amortisation/impairment of intangible fixed assets (other than player registrations), expenditure on youth development activities, expenditure on community development activities, any other non-monetary items, finance costs directly attributable to the construction of tangible fixed assets, tax expenses or certain expenses from non-football operations.”

4 Article 58 (1) clarifies the notion of relevant income as follows: “Relevant income is defined as revenue from gate receipts, broadcasting rights, sponsorship and advertising, commercial activities and other operating income, plus either profit on disposal of player registrations or income from disposal of player registrations, excess proceeds on disposal of tangible fixed assets and finance income. It does not include any non-monetary items or certain income from non-football operations.”

5 The “monitoring period” assessed for the license season 2013/14 covers the reporting period ending 2013 and the reporting period ending 2012. From then onwards the three previous reporting periods will be assessed for every new license season. For example, in the 2014/15 license season the assessment will be performed based on the three reporting periods ending 2014, 2013 and 2012.

6 The notion of „acceptable deviation“ is defined in Article 61.

7 Article 61(2) of the FFP regulations (UEFA 2012) explains that the total acceptable deviation is fixed at € 30 m for the monitoring period assessed in the license seasons 2015/16, 2016/17 and 2017/18. A lower amount to be decided in due course by the UEFA Executive Committee will be binding for the monitoring periods assessed in later years.
in salaries and transfers with the result that relevant expenses exceed relevant income by more than the “total” acceptable deviation.

Knowing *ex ante* the “normal” acceptable deviation plus the maximum “external rescue package” taken into consideration by UEFA for licensing purposes, football managers will have no more options to soften their clubs’ budget *ex post*. If they wish access to European competitions, managers will have to run clubs based on payrolls that allow them to stay within the hard limit drawn by their football income and the “total” acceptable deviation defined in the FFP regulations.

As every new regulatory measure, FFP has encountered substantial critique. This critique falls into three different categories:

1. UEFA issued a regulation that forgoes potential benefits arising from substantial injections of “external” money into football payrolls (e.g. Madden 2011).
2. UEFA issued a regulation that limits competition in the player market and puts downward pressure on wages like a US salary cap, but without compensating through benefits from increased competitive balance (e.g. Peeters and Szymanski 2012).
3. UEFA issued a regulation that will “ossify” or “freeze” the hierarchy of European football, creating a barrier to entry (e.g. Vöpel 2011, Sass 2012).

It is the purpose of this paper to take these concerns as a starting point for discussing the likely effects of the new regulations. As a by-product it will become obvious why and in which points the concerns are unfounded.

An extended debate of criticism 1 is offered in Section 2. It turns out that limiting “external” money injections through FFP does not simply translate into “less money for football payrolls” but rather into “restoring efficient managerial incentives”. The time for repeated managerial moral hazard and rent-seeking games in European football is over if FFP comes into action. Football managers will have to concentrate on productive efforts to develop the football business as a whole and in a sustainable way instead of focusing on “payroll-gambling” in a sort of “football casino”. It is true that “some” external money will not find a direct way into

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8 In this article the likely effects of FFP are discussed without raising the difficult question of enforcement. I am well aware of the fact that many commentators are also criticizing FFP on the grounds that UEFA will not be successful in preventing circumvention of the break-even requirement, pointing to the possibilities arising for example from inflated sponsorship deals, third party ownership of players etc. It seems reasonable to assess this open question after the first experiences with the application of the break-even requirement in 2014.
football payrolls any longer due to the capped maximum rescue package of benefactors. However, as FFP restores incentives for “good management” in football clubs, new revenues will be generated, which in the end could allow the payment of even higher salaries than in the current system.

Criticism 2 portrays FFP as a restrictive measure comparable to a US salary cap. However, a closer look at the regulation in Section 3 shows that, contrary to a US salary cap, FFP formulates a very “tolerant” restriction of competition, which would not even be binding in any “normal” business environment. Downward pressure on salaries is only a transient effect that makes sense in an industry characterized by massive overspending. Moreover, US salary caps are the wrong benchmark for assessing the potential of FFP to contribute to more vibrant competition in the open European football system.

Criticism 3 claiming an “ossification” of the football hierarchy through FFP obviously assumes that “small clubs” can only or can better challenge “large clubs” in a system of unlimited money injections. Section 4 challenges this assumption. There is no mechanism, which systematically allocates “unlimited” money injections according to a pattern that makes small clubs relatively more competitive. Instead, the existence of an inverse mechanism, making sure that “money comes to money”, is much more plausible. Breaking the “money comes to money” dynamics and increasing the importance of “management quality” through FFP could be a more reliable way to shake established football hierarchies.

2. WHY CAPPED MONEY INJECTIONS ARE NOT SIMPLY “LESS MONEY FOR PAYROLLS” BUT RATHER “INCENTIVES FOR BETTER MANAGEMENT”

Simply put, the question is: Why do the rules require that by and large “all clubs should compete within the limit of the financial resources they generate in football” instead of just requiring that “all clubs should compete within the limit of the financial resources they somehow generate”? If a club manages to organize the external funds needed for repeated bailouts, it will stay in operation despite chronically overspending and “the show simply goes on”. Why should we care? At first sight money injections seem to be beneficial as they bring “additional money” into the game, which – under certain assumptions – raises the level of

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9 Paul Madden has formulated this important question in direct communication with me.
playing talent, makes consumers happier, players wealthier, etc. Unfortunately, unregulated money injections do not simply translate into “more money for the payroll”, but they have the potential to adversely affect managerial incentives and decision-making in football. To see why, let’s look at the two basic forces that shape the investment incentives of clubs.

2.1 The Contest Logic Of Football Competition

Football championship races are examples of a certain form of economic competition, which is known as contest in the literature. Even if we assume rational behaviour and profit-maximizing clubs, contests may exhibit an interesting phenomenon of revenue dissipation called overinvestment. It has been shown that various factors aggravate the problem of overinvestment in the football industry, for example:

- A stronger correlation between talent investment and winning probability (a higher discriminatory power of the contest success function)
- Simultaneous (as opposed to consecutive) investments
- An additional exogenous prize (e.g., UEFA Champions League qualification)
- A system of promotion and relegation
- Increasing revenue differentials within a league (i.e., less revenue sharing)
- Increasing revenue differentials between hierarchical leagues

As explained elsewhere (Franck 2010), both increased commercialization and the implemented format of competition in European football have presumably positively impacted on these triggers, thus increasing the incentives to gamble on sporting success and overinvest in playing talent. Overinvestment and gambling on success are to some extent “normal” in this environment. They are “normal” in the sense that even rational and profit-maximizing clubs would engage in such dissipation of revenues.

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10 Madden (2011) has presented an article where he shows, based on a theoretical model, that the prohibition of money injections has negative welfare consequences for the league, because of its adverse effects on team qualities.


13 See Dietl, Franck and Lang (2008) for these results and their theoretical derivation.
However, the concept of overinvestment, which explains why even profit-maximizing clubs would fail to maximize profits at the league level, is not sufficient to understand the “extreme” dissipation of revenues that has brought many clubs into a situation where the value of their liabilities exceeds the value of their assets.\(^\text{14}\) In other words, the idea of an arms race is too weak to describe competition in an industry that continues to operate in full swing despite the fact that a substantial part of the participating competitors is technically bankrupt.\(^\text{15}\) The term “zombie race” seems to be more appropriate in this context. Obviously, the transition from an arms race to a “zombie race” requires that the “normal” threat of dissolution of the club in case of insolvency is not functioning as a hard constraint. This leads us to the second element of the story, the Soft Budget Constraints (SBC) under which the majority of football clubs operate.

2.2 The Soft Budget Constraints Of Football Clubs

The observation that football clubs do not face the same threat of dissolution as firms in other industries when systematically failing to balance their books is not new at all. Both sports economists and journalists have dealt with the issue extensively.\(^\text{16}\) The renowned British sports journalist Simon Kuper brings it to the point when he writes:

“Clubs are immortal chiefly because creditors dare not pull the plug. The club’s brands are strong enough to cow banks and taxmen. And so clubs can incur debt without fear... Much of football’s debt will never be repaid. So it will be written off. Large chunks will be nationalized…” (Kuper 2009).

As Szymanski (2009) has stressed, the mechanism leading to the result that “clubs can incur debt without fear” (Kuper 2009) is similar to the mechanism known as “too big to fail” from the banking sector. To my knowledge the first sports economist linking footballs’ permanent and inbuilt financial crisis to the theory of Soft Budget Constraints (SBC) pioneered by Janos Kornai (1980a, 1980b, 1986) has been Wladimir Andreff (2007, 2011). Recently Storm (2012)

\(^{14}\) As mentioned in the introduction the percentage of clubs with negative net equity facing a situation with debts larger than reported assets is 38% (see UEFA 2013).

\(^{15}\) For example, as of January 2013 Deportivo La Coruna became the eighth club in the Spanish first division to file for bankruptcy protection.

\(^{16}\) See for example Szymanski (2010), Kuper (2009), Kuper and Szymanski (2009), Baroncelli and Lago (2006), Lago, Simmons and Szymanski (2006).
and Storm and Nielsen (2012) have also proposed to analyze football clubs as special cases of the SBC phenomenon initially studied by Kornai in post-socialist countries.\footnote{Budzinski and Müller (2012) also deal with - among many other things - the issue of repeated bailouts in their paper about financial regulation and international competitiveness seen from the perspective of the German Bundesliga.}

Some form of “supporting organization” (Kornai, Maskin and Roland, 2003, p. 5) steps in with a sufficiently high probability in case of a deficit of the football club and relieves the club from the pressure to “cover its expenditures out of its initial endowment and revenue” (Kornai, Maskin and Roland, 2003, p. 4).

SBC theory deals with a rather complex chain of causality between the following three factors (Kornai, Maskin and Roland 2003, p. 15-16):

a. The political, social and economic environment that generates the background for the development of SBC expectations.\footnote{In Kornai’s classical treatments (Kornai 1980a, 1986) the post-socialist transition created specific conditions that nurtured the emergence of a SBC mentality.}

b. The motives of the supporting organization within this background to step in ex post and bail out the otherwise insolvent organization (in our case the club). While the motives of the latter to ask for rescue are quite self-evident (almost trivial in the case of profit-oriented organizations and still very straightforward in the case of non-profit-organizations, where remuneration, prestige and power of their leaders remains attached to organizational survival\footnote{See Kornai, Masin and Roland (2003, p. 7) for more details.}), the motives of supporting organizations can be very diverse.

c. The inefficiencies generated by the SBC syndrome.

The literature on the SBC syndrome is very rich, both in formal models treating mostly the link between elements \(b\) and \(c\) in rather restricted and specific fields of study, as well as in conceptual and empirical investigations focusing more on element \(a\) and on the links between \(a\) and \(b\).\footnote{For excellent overviews see Kornai, Maskin and Roland (2003), Maskin (1996), Dewatripont, Maskin and Roland (2000) etc.} Storm (2012) deserves tribute for an insightful adaptation of Kornai’s SBC concept to the specific environment of European football. His treatment of element \(a\) covers a wide range of interesting and relevant topics in the political, social and economic environment that contributes to the development of SBC expectations (Storm 2012, p. 23-30). However, elements \(b\) and \(c\), that is the motives of supporting organizations, the typical set of SBC-
induced inefficiencies and the mechanisms through which these are generated, require a more detailed and comprehensive explanation (Storm 2012, p. 30-32). Thus, I would like to focus more on elements $b$ and $c$ in the following analysis.

Two types of supporting organizations are typical for the football industry: the state and private benefactors.

### 2.2.1 The State As Supporting Organization Softening The Budget Constraints Of Football Clubs

“Soft taxation”, “soft credit” and “soft administrative prices” are examples of rescue measures taken by the state in order to bail out football clubs. A typical form of a “soft administrative price” would be the use of a municipal stadium based on an agreement that allows for ex post adjustments of the price once the football club is in trouble. “Soft credit” occurs when the credit contracts of state banks or state controlled banks with football clubs are not enforced but instead routinely postponed and rescheduled. Similarly, “soft taxation” refers to the toleration of tax debts by the state tax office.

Currently, Spanish football clubs provide a prominent example for the SBC syndrome generated by constant failure of the Spanish state to enforce its tax laws. According to Van Rompuy (2012) Spanish football clubs owed € 750m in taxes and € 600m in social security to the Spanish state and therefore ultimately to the Spanish taxpayer as of September 2012. Faced with the allegation to treat football clubs more favourably than taxpayers in times of austerity measures and with the accusation to provide state aid and distort competition in European football, the Spanish government drew back from an initial plan to give tax amnesty to football clubs. Instead, an agreement with the Spanish Professional Football League was reached in April 2012 to regain control over tax payments. However, the new measures have to be interpreted in the broader context of past measures that proved as failures to enforce tax laws.

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21 See Kornai (1986, p. 5-6) for a more detailed account of the possible measures of state intervention.

22 There is some uncertainty concerning the correct numbers. As far as I can see the “lower bound” has been announced by the Spanish State Secretariat for Sport in February 2014. According to this announcement the aggregate tax and social security debts of clubs at the end of the 2012/13 season amounted to “only” € 750m.

23 See Van Rompuy (2012) for this and for all the following details of the Spanish situation.
As early as 1984 a debt restructuring plan was agreed between the Spanish government and a committee of club presidents that provided for 2.5% of the revenues from the Spanish football betting pools to be reserved as guarantee for outstanding taxes.

With the advent of competition in the betting industry the state pools collections went down and clubs simply piled up new debt. A second debt-restructuring plan came in 1990 with a new law, the Spanish Sports Act. Only Spanish clubs that had shown positive capital balances over the playing seasons 1985/86 to 1898/90 were allowed to remain members’ associations (Barcelona, Madrid, Bilbao and Osasuna). The rest of the clubs were transformed into sports joint-stock companies with limited liability in the hope that professional business governance structures would improve financial accountability. Moreover, the newly formed sports joint-stock companies were relieved from old tax debts by passing these over to the league, which in turn received a share from the football pools as compensation. As joint-stock companies, the clubs also raised new capital on the market to cover their other debts. Nevertheless, the overinvestment spiral continued, and the clubs began piling up new tax debts immediately.

The “new” protocol signed on 25 April 2012 requires that from the season 2014/15 onwards the clubs will have to set aside 35% of their revenues from audiovisual rights sales as guarantee against tax and social security obligations, which they are expected to settle by 2020.24 However, doubts persist that this new agreement will contribute to the enforcement of tax laws in Spanish football.

Firstly, Van Rompuy (2012, p. 2) points to the fact that the first division in Spain only generates one third of its revenues from broadcasting rights. Since clubs are individual sellers, more than 50% of media revenue is appropriated by Real Madrid and FC Barcelona, leaving a “normal” club at approximately €15m per year.

“In fact, it remains unclear how the obligation to set aside 35% of revenue from selling broadcasting rights will allow clubs to repay their tax debts” (Van Rompuy 2012, p. 2).

Secondly, the “shadow” of the past plays an important role in shaping the future expectations of the clubs. The long history of commitment failures to enforce the tax laws by the Spanish state cannot be simply “deleted”. Van Rompuy (2012, p. 2) gives an illustrative example:

“The problem is that the leeway given by the Spanish tax authority (in the past) has very much contributed to the problem of overspending clubs. It is clear that the Spanish football

24 I am still following Van Rompuy (2012) for all details.
clubs had little incentive to prioritize tax repayment over other outgoings. To give an example: the Scottish club Rangers was forced into administration after running up £9 million in unpaid taxes. In Spain, the enormous tax debt of € 155 million proved no barrier to Atlético Madrid to buy the top striker Falcao for a club record deal of € 40 million in August 2011.”

The conduct of the Spanish state in the past has created what Kornai, Maskin and Roland (2003, p. 12) call an SBC mentality among Spanish clubs. It is part of the collective experience of Spanish clubs that the state bails them out of financial trouble by failing to insist on payment of taxes and social security.

But why does the state behave as supporting organization for otherwise insolvent football clubs at all? What are the possible motives for failing to collect taxes, rescheduling state bank loans, renegotiating infrastructure prices, etc.? The following two motives seem particularly relevant:

a. Past “softness” makes bailouts in the present rational

It is in the state’s own interest to bail out the clubs because it would lose previous investments (credits, uncollected taxes etc.) if the clubs went out of operation. Pushing the clubs to extinction by immediate strict enforcement of the tax laws would mean having to write off a substantial part of the tax and social security debts they have already accumulated, so the Spanish state defers calling the clubs to full account until 2020 to minimize this risk. Past “soft” behaviour makes it rational for the state to choose “soft” behaviour in the present, which unfortunately confirms the SBC expectations of the clubs. In this sense the shadow of its own “bailout past” creates a commitment problem for the Spanish state in the present.

25 In addition to these rather general motives highlighting different aspects of state commitment difficulties, Kornai, Maskin and Roland (2003, p. 9-10) also explore more specific motives for bailouts, which cannot be ruled out categorically but might apply in single cases. They range from “crony” relationships based on bribery or political pressure to reputational and paternalistic concerns in situations where the club is perceived as a “lower-level unit” of the same “organization”. For example, if the club is to a large extent operated by the city or the region, as is still the case in many post-socialist settings, state officials may both feel responsible for it and at the same time fear to lose public standing in case of a club collapse.

26 See Kornai, Maskin and Roland (2003, p. 8) for this argument presented in a general context.

27 A famous model by Dewatripont and Maskin (1995) elaborates this idea that „softness“ develops out of investing in order to save past investment.
b. Miscalculation of bailout costs by political decision-makers with limited time-horizons

Even in the situation of a first bailout, when there are no past investments to recoup, the shutdown of the club is accompanied by collateral damage to the local economy, which a rational state has to weigh against the bailout costs. A lot of elements may add up to collateral damage: For example, fans and supporters would lose their joint object of identification and would have to at least temporarily write off emotional and social capital leading to a “wave” of unhappiness. Additionally, employees of the club would lose their jobs, thus raising unemployment in the city; supplier bills would not be paid, which might cause other bankrupctcies; the municipal stadium would lose its most important tenant; a valued leisure opportunity would at least temporarily disappear, which might make potential voters unhappy; the image of the city would deteriorate, which might discourage investors, etc. The bailout package for the club usually includes giving tax and social tax reliefs by writing off respective claims or accepting long-term payables, extending credit lines through a state controlled bank, providing infrastructure below cost, bringing in new sponsor deals from the state controlled or dependent utility sector at prices above fair value or allowing a real estate development project around the stadium combined with some sort of facility relocation. In the case of a prominent local football club supported by numerous fans, bailout tends to be the lesser of two evils for the state.

Naturally, the managers of the club perfectly understand this calculation that the state has to make and adapt their behavior accordingly. Assume that the managers have two investment options. First, they could act in a responsible manner by making a solid investment in player talent and aspiring to a mid-table position in the championship. Such investment behavior would generate only moderate levels of enthusiasm and glamour, but would almost certainly lead to balanced accounts. Second, the managers could expend much more on players than in the first scenario in a gamble to achieve UEFA Champions League qualification. This approach would generate much higher levels of enthusiasm and glamour and, if successful, the additional revenues from prize money, TV, attendances etc. would lead to balanced accounts on top of it. However, should the gamble go wrong, the revenues needed to pay the salaries, transfers, social security taxes, etc. for the much more expensive squad simply would not materialize. The normal consequence of being unable to pay open bills is the opening of insolvency proceedings. However, if it is clear that the local government fears the collateral

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28 The story told below follows quite closely the logic of the “too big to fail” problem in banking, which has been explained to me by my colleague Urs Birchler in his inaugural lecture at the University of Zurich.
damage of a club bankruptcy more than the cost of the required bailout package, managers can expect to be rescued with high probability. As a consequence, gambling on success becomes more attractive for football club managers that are “insured” against failure by the state.

Unfortunately, this bailout game has the potential to become an infinitely repeated game. For the club and its managers similar investment scenarios come up again every season. Therefore, in reality the rescue project does not consist of a single bailout package but of a geometric progression of bailout packages. Of course, the state could rescue the club once and announce that there will be no more bailouts in the future. However, will future politicians really be willing and able to adhere to this “old” declaration when faced with a similar situation during their term of office where a bailout package appears less painful than the collateral damage caused by club extinction? Considering the political realities characterized by the limited time-horizons of political decision-makers, the state is presumably better portrayed as an agent with commitment difficulties into the future.

The consequence of comparing the cost of an isolated bailout with collateral damage instead of anticipating the entire progression of future bailout packages is straightforward: Too many clubs will be rescued too often by the state. Moreover, once the bailout activity gets started the “soft commitment trap” described in a kicks in additionally. The next rescue intervention is, of course, again the only intervention taken into consideration when weighting the costs against the benefits of a bailout. But now it is even clearer that the state must rescue the club because it would lose previous investments (rescheduled credits, uncollected taxes, etc.) if the club went out of operation. Club managers can rely with even higher probability on being bailed out and cultivate what has been called a SBC mentality.

2.2.2 Private Benefactors As Supporting Organization Softening The Budget Constraints Of Football Clubs

According to the newest UEFA benchmarking report (UEFA 2013, p. 117), the European top-division clubs reported a net non-profit-related equity increase of € 1.279 bn in the financial year 2011. This number gives an estimate of the ad hoc capital injections (new equity, write-off of loans or revaluations) provided by first division club owners in order to cover the losses and liquidity shortfalls of their clubs. Private owners, dubbed “sugar daddies”, who pay the open bills of their clubs year after year have become a typical phenomenon in football outside
Germany, where regulation still requires that members’ associations hold residual control (50% + 1 vote rule) of all professional football teams.\(^2^9\)

Well-known English Premier League examples of such benefactors are Roman Abramovich, who had injected around £ 1bn into Chelsea by 2012 (Conn 2012a), when the club finally won the UEFA Champions League, and Sheikh Mansour, who had already spent the same amount in the four years up to 2012 at Manchester City (Conn 2012b), winner of the Premier League Championship in 2011/2012. In Italy Massimo Moratti by 2012 spent € 1bn paying the open bills of Inter Milan year after year, while Silvio Berlusconi had injected approximately half of this sum at AC Milan (Iaria 2012). As to the total amount the 10 biggest benefactors had injected into Italy’s Serie A up to 2012, Iaria (2012) summarizes:

“The exact total is € 2.483 billion. That figure includes every single financial contribution, be it a cash investment or revision of financial situation that has been necessary to keep the clubs afloat. In layman’s terms: without that money, football in the ‘Belpaese’ would no longer exist. Moratti at Inter, Berlusconi at Milan, Agnelli at Juventus, Garrone at Sampdoria, Della Valle at Fiorentina, Preziosi at Genoa, Zamparini at Palermo, Pozzo at Udinese, De Laurentiis at Napoli, Lotito at Lazio…”

Losing money in football can be rational for a sugar daddy once and even on a repeated basis because bailout costs need to be weighed against different positive spillovers generated through ownership of the club. As analyzed in detail elsewhere\(^3^0\) benefactors running football clubs may profit from the publicity and support provided to their other businesses, from gains in legitimacy and public acceptance, from direct access to the substantial cash transactions of a business characterized by significant money laundering potential, from the prestige of owning and controlling a high-class object of consumption etc. As Iaria (2012) comments on the benefactor role of Silvio Berlusconi at Milan: “It’s almost impossible to untwine football from his political and business dealings.”

Even if a high number of bailouts make sense economically for the club owners after weighing the costs against the benefits from the mentioned diverse spillovers, sugar daddies, too, can slide into the soft commitment problem described above: Against a history of heavy

\(^2^9\) However, even in the Bundesliga there are historical exceptions from this regulation, namely Bayer Leverkusen and VfL Wolfsburg, who have always been sub-organizations of the corporations Bayer and Volkswagen.

\(^3^0\) See Franck (2010) for an in-depth treatment of this issue.
prior investment, club managers, players and other employees will assume that the owner will not just let his club go bankrupt in the case of a new deficit. Whether the bailouts are produced by entirely rational legitimacy seekers, advertising purchasers, sportsman owners or money launderers or by the same people additionally captured in a soft commitment trap, their effect on club decision-makers is always the softening of the budget constraints and the development of an SBC mentality. Now, what is wrong with an SBC mentality?

2.3 Inefficiencies Resulting From The SBCs Of Football Clubs

It surely makes a difference whether taxpayers (as in the Spanish case) or private benefactors (as with Chelsea or Inter in the past) are bailing out football clubs. As already mentioned, Atléticos Madrid paid € 40m in the transfer of Radamel Falcao while at the same time failing to service a tax debt which was about three times higher. It seems likely that many Spanish tax-payers contributed to this deal against their own will, by having to accept higher tax rates or simply more financial risk.

In contrast, private actors generally do not make uninvolved citizens liable for their football investments and should therefore be free to spend their wealth as they wish. Or to quote Stefan Szymanski characterizing the situation in English football:

“…there has been a sorry procession of one failing businessman after another – but why should the rest of us worry when they lose their money (Szymanski 2009)?”

However, concentrating on the question of whether public or private money is used for bailouts diverts from the main problem: Bailouts distort the incentives of decision-makers in football clubs. And in this respect there is little difference between the bailouts of the state and the bailouts of private sugar daddies.

2.3.1 Decreasing Price-Elasticity Of Demand, Talent Shortage And The Formation Of A “Salary Bubble”

“Expenditure on purchasing inputs is conditional on past, present and future revenues generated by the sale of output, which again is constrained by the demand for the firm’s output. If, however, the budget constraint of many firms is soft, their demand for inputs becomes unconstrained (or at least unconstrained from the point of view of financing). Run-away demand will appear. These firms feel that when they cannot pay the bills, someone else
will step in and bail them out. Therefore there is no compulsory limit on demand for inputs, and particularly, on investment. If the share of economic units with a soft budget constraint and a tendency to run-away demand for inputs is large enough to have a strong effect on total demand, the system becomes a “shortage economy” (Kornai 1986, p. 11).

In the extreme case that a club has a perfectly soft budget constraint\(^{31}\), its own price-elasticity of demand is zero, which means that the vertical demand curve for player talent – the crucial input into football production – is only determined by other variables and not by the price (Kornai 1986, p. 9). Given that winning is desirable for club decision-makers and talent contributes to winning, the direct consequence of the soft budget constraint is the formation of excess demand for player talent, provided that the supply of talent is not sufficiently elastic.

A closer look at the technology of football production reveals that talent supply is highly inelastic by definition. The regulatory framework determines the squad size of the teams that confront each other on the pitch. Unlike in many other areas of production, where one productive worker can be substituted by two or more less productive workers without any problem, the coach cannot take out one player and field two or more in his place. If he wishes to field a more successful team, the coach can only substitute players through better (not more!) players. Under such conditions talent refers only to the relative quality of players:

“Indeed, the most important input of all – highly talented players – is in extremely limited supply. This is because the very definition of talented player is inescapably relative – simply put, such a player is one who is better than most others” (Frank and Bernanke 2004, p. 113).

The supply of players that are better than most others is limited by definition. In an industry where “slot restraints” systematically block the possibility to substitute players like Messi or Ronaldo through entire armies of “normal” footballers, this limit becomes highly relevant. Using the terminology of Frank and Bernanke (2004, p. 113), talent, as the capacity of a player to be better than most others, is a unique and essential input that creates the ultimate supply bottleneck in football. Just as there is only one best player in the world at any point in time the number of \(x\) players that are better than all other players will be \(x\) at any point in

\(^{31}\) Bairner (2012) compared the spending of Chelsea, Manchester City and Paris Saint-Germain in the first 14 months after the respective new owner took control. The numbers (€ 283.6m for Roman Abramovich, € 234.3m for Sheikh Mansour and € 212.6m for the Qatar Investment Authority) are indicative of a perfectly soft budget constraint.
time. Thus, talent supply, properly defined in the specific context of football production, is highly inelastic.\(^{33}\)

This means that if enough clubs have soft budget constraints and a very low price-elasticity of demand for talent as a consequence, then talent (in the sense of players with the capacity to be better than most others) becomes extremely scarce and its price gets bid through the roof. Football exhibits the characteristics of a “talent shortage economy”\(^{34}\), where player costs reach levels that are totally unsustainable without systematic new money injections. In other words: Considering the relativity of talent in football production, soft budget constraints create a genuine “salary bubble”.

### 2.3.2 Managerial Moral Hazard: Too Much Risk And Too Little Care

\(^{32}\) Here we abstract from the fact that some talent indicators are exclusively observable for the current team, which may give rise to problems of asymmetric information. Moreover, the impact of a player on team performance could differ with the team as a consequence of joint production. Thus, a player can be more valuable for one team than for another team. Despite some uncertainty added through these factors, players like Ronaldo, Messi or Ribery (nominees for the Ballon d’Or 2013) have obviously disclosed their superior abilities to many observers of their weekly performances on the pitch and would be considered as “high contributors” in most clubs.

\(^{33}\) I don’t dare to use the term “perfectly inelastic” for the following reason: For the sake of simplicity let’s only call the five best players of the world talented. Assume the five best players of the world are A, B, C, D and E. If salaries in the entire world football industry go up by 10% over night, these players remain the same and the number of the five best players of the world remains five. No new talent in the sense of the five best players of the world enters the market. However, the interpretation changes if we segment the football industry along national borders. Assume that salaries only go up by 10% in England. Assume that so far only two of the five best players of the world played for English clubs (A and C). As a result of the salary increase in England one more player from this group moves from Spain to England (B). Seen from the perspective of the English League (which now has three of the five best players of the world, A, B and C) supply of talent is elastic despite the fact that the five best players of the world are still five and even the same five. Paul Madden and Brian Quinn have attracted my attention to this simple and important truth. However, since we analyze a regulation addressing clubs that participate in European competitions, the adequate “jurisdiction” seems to be Europe for me. If regular Champions League competitors like Barcelona, Madrid, Chelsea, Manchester etc. bid for the five best players of the world, new talent only enters the market if one of the five best players in the world doesn’t already play in Europe and if a European club succeeds in hiring him. Occasionally it can be the case that a player comes as a “top star” to Europe, like recently Neymar. Therefore, I think that it is safe to say that talent supply is not perfectly but highly inelastic seen from the “jurisdiction” of the European competitions addressed by FFP.

\(^{34}\) It is irrelevant that “less talented” or “untalented” players might offer their services in the market “for nothing”. Demand concentrates on the inelastic number of “star players” at any point in time.
Runaway demand for talent is only one consequence of the declining price-responsiveness of football clubs operating with SBC. Risk-escalation is another:

“The firm can start a project even though it may have the subconscious suspicion that the cost will be more than planned and the revenue less. In case of financial failure it will be bailed out. Under such circumstances there is no self-restraint in investment intentions; the demand is not counterbalanced by a “dead-serious” consideration of revenues and ultimately of supply” (Kornai 1986, p. 12).

Franck and Lang (2012) have formally shown that as soon as the option to be bailed out with a certain probability is introduced, club decision-makers are induced to take more risk in their investment decisions. The emergence of such moral hazard behavior is not surprising. Studies in other areas demonstrate that managers tend to take excessive risks if they can expect to be bailed out ex post. A prominent example is the “too big to fail” problem in the finance sector (e.g. Stern and Feldman 2004).

Moreover, the absence of what Kornai (1986) called “dead-serious” considerations of revenues and supply can induce managerial negligence. As the continuation of operations is not at stake, decision-makers do not invest enough of their own time and energy into sorting out bad projects and developing good projects. “Money coming like manna” (Kornai 1986, p. 12) induces waste and lavishness.

2.3.3 Managerial Rent-Seeking: Weak Incentives To Innovate And To Develop The Business

Instead of taking care of the production and provision of a competitive service, managers of SBC-organizations concentrate on winning the favor of benefactors.

“Allocative efficiency cannot be achieved when input-output combinations do not adjust to price-signals. Within the firm there is no sufficiently strong stimulus to maximum efforts; weaker performance is tolerated. The attention of the firm’s leaders is distracted from the shop floor and from the market to the offices of the bureaucracy where they may apply for help in case of financial trouble” (Kornai 1986, p. 10).

If such rent-seeking behavior is systematically rewarded in SBC-organizations, their managers invest less effort and energy in developing the business by “improving quality, cutting costs, introducing new products or new processes” (Kornai 1986, p.10). Productive efforts can easily be substituted by asking the sugar daddy to compensate for unfavorable
developments. In a dynamic perspective SBC-organizations will be less innovative and their managers less entrepreneurial.

2.3.4 The Systemic Effect Of “Unlimited” Money Injections Into Payrolls: Crowding Out Of Incentives For “Good Management”

Obviously, those clubs that do not have soft budget constraints find themselves victims of the “salary bubble” produced by the clubs with soft budget constraints. Trying to maintain their existing level of playing strength by keeping their share of “star players” would require spending significantly more in the player market. At first sight this could generate a strong incentive to further increase efficiency through “better management” in order to remain competitive on the pitch.

However, if the margin to further increase efficiency through “better management” becomes too small compared to the “buying power” originating from money injections of benefactors at their competitors, these clubs will have to accept sporting decline or to change sides and start gambling on success by investing more aggressively. Since there is no doubt at all that sporting decline generates disutility for decision-makers and fans of the club alike, the soft budget constraints of some clubs clearly intensify the incentives for other clubs to overspend as soon as the external money injections have reached a magnitude that makes all reasonable efforts to increase efficiency through “better management” look ridiculous. In this sense “unlimited” money injections and “really” soft budget constraints have a tendency to crowd out incentives for “good management” and to propagate throughout the entire league.35

In the end managerial moral hazard and rent-seeking tend to become infinitely repeated games in a league where the expectation of being bailed out has become part of collective experience. The potential arms race mutates into a zombie race, where an entire league operates on the verge of insolvency, chronically expending more than its earnings, but being systematically rescued by external money injections year after year.36

35 As my colleague and friend Umberto Lago expressed in direct communication with me: “If you do not regulate the industry it does not mean that you can have different management models competing for success, because “pleasing the sugar daddy”, like weed, kills (or makes life too difficult for) competing management models.”

36 One might argue that this state of affairs has already been reached in the entire European football industry, given that 63% of the European top division clubs report operational losses and 38% of these clubs face a situation with debts larger than reported assets in the financial year 2011 (see UEFA (2013), p. 15, 101).
2.4 The Role Of FFP In This Context: Hardening The Budget Constraints Of Clubs

Against this background, FFP can be seen as an instrument for moving from a state of affairs with very soft budget constraints to a state of affairs with harder budget constraints in the football industry. What can be said against this regulatory strategy?

To begin with, critics may counter that only genuine insolvencies of football clubs, the Schumpeterian “creative gale of destruction”, could introduce truly hard budget constraints and restore efficient managerial incentives in the football industry. UEFA, in contrast, embarks on a regulation that tries to avoid insolvencies altogether by encouraging clubs to live within their means and develop sustainable business models.

My answer would be that UEFA has gone as far as it can go with FFP in hardening the budget constraints of football clubs. First, the pre-FFP situation of European football cannot count at all as a Schumpeterian world cleaned by a “creative gale of destruction”. Instead it is populated by a large number of technically insolvent clubs, which continue to operate as “zombies”. The pre-FFP reality is the SBC-syndrome and not Schumpeterian capitalism.

Second, UEFA is not a national government with the competence to issue and implement insolvency legislation in a specific country in which a certain club playing in European competitions operates. Third, and most important, it doesn’t make sense to regulate football in order that it becomes a truly Schumpeterian world cleaned by a “creative gale of destruction”.

Peculiarities like the associative character of competition in sports and the mutual interdependence of sports clubs (Rottenberg 1956, Neale 1964) mean that the shutdown of a club has the potential to produce substantial negative externalities: The failure of the insolvent club to complete the season harms the integrity of the interlinked league competition(s) and has negative reputational (and financial) spillovers on uninvolved

However, there are significant national differences regarding the aggregated annual profits and losses and debt levels of first division clubs, as Drut and Raballand (2012) show in their paper. They explain these differences as a reflection of more or less tight national systems of financial regulation in football. German and French first division clubs have been less prone to fall into the spiral of overspending because – to use the terminology of this paper – their regulators imposed much harder budget constraints on them. According to Drut and Raballand (2012) they have paid the price of a sporting disadvantage.

37 If I recall the details correctly, it was Stefan Szymanski who confronted me with this argument at a roundtable discussion in Barcelona.

participants, unpaid financial obligations to other clubs from player transfers may lead to contagion, etc. Because the implementation of the Schumpeterian “creative gale of destruction” in an industry where competitors are substantially interlinked through joint production comes at the price of negative externalities, UEFA should not pursue this regulatory strategy even if it could (which is not the case, for the reasons given above).  

The presumably most important and accepted criticism against the new regulation can be expressed as follows. In the past (before FFP) the absorption of club losses by the owner at the end of the year was a common measure to keep football clubs afloat. Because FFP caps the payroll injections of benefactors, there is a general suspicion that substantial amounts of money will simply be missing in the football business. At first sight a downward development could be initiated because “less money” could translate into “less quality on the pitch”, lower salaries, unhappier consumers, etc.  

However, the translation of “capped payroll injections” into “less money” for football is far less obvious than generally assumed. A substantial part of what has been called the absorption of losses by the owner in the past will simply become a fair market value transaction in the future. Quite often owners of football clubs are “diversified entities” engaged in different businesses. For example, Bayer Leverkusen AG, the German chemicals company, is the 100% owner of Bayer 04 Leverkusen Fussball GmbH, which operates the Bayer Leverkusen professional football squad. The question to be answered is: How much would the Bayer Leverkusen AG have to invest in PR activities per year in order to achieve a similar level of brand awareness as produced by the Bayer football team? The corporation Bayer could continue to absorb losses of this level at its subsidiary club under FFP by simply concluding a sponsorship agreement and paying the fair market value sponsorship fee. In the past many diversified football club owners simply did not bother to conclude formal sponsorship agreements because they were free to inject money ex post and absorb losses in exchange for the publicity received for their other businesses. Thus, it is not true that all the money previously injected by owners into payrolls will be missing in the future. Owners will simply adapt to FFP and write fair market value sponsorship contracts in the future. However, in

39 See also Budzinski and Müller (2013), p. 12-13 for a critical discussion of “adequate” regulation in situations where insolvencies lead to negative externalities.

40 Such downward development is modeled by Madden (2011): Provided that talent supply is sufficiently elastic, “less money” translates into lower team qualities, unhappier consumers, etc. In the end everybody is worse off.
contrast to the ex post absorption of losses common in the past, sponsorship deals have to be concluded ex ante. Because managers of football clubs have complete knowledge of the sponsorship revenues, which are a component of relevant income, they have no reason at all to develop any kind of soft budget constraint expectations. In other words: Unlike the traditional ex post absorption of losses, fair market value sponsorship agreements do not create soft budget constraint expectations with all the incentive problems associated to them.

In sum, FFP will neither lead to a situation where owner money injections into football are impossible, as investment outside payrolls remains *entirely unregulated*, nor to a situation where all former money injections into payrolls disappear, as presumably most of them can be executed as normal sponsorships in the future. Only payroll injections that constitute contributions above the fair market value of a good or service exchanged between the club and the owner/related party will not be counted under FFP. If, for example, Bayer AG would pay more to its subsidiary club in a sponsoring agreement than a comparable amount of exposure/image transfer costs in the free market, it would obviously inflate relevant income, allowing the club to operate at a higher level of relevant expenses before getting into conflict with the break-even rule. Ceteris paribus the club would compete with higher playing strength than otherwise identical competitors without benefactors. By capping such “inflated” owner payments into payrolls above the fair market value of exchanged goods/services, it cannot be excluded that FFP prevents “some” money to flow into football in the future.\(^{41}\) However, there are several compensating effects overlooked in the literature so far:

a. Money that would otherwise have been immediately expended on players may be instead invested in stadia, infrastructure, community projects and youth academies, where budgets remain unconstrained under FFP, thus generating sustainable “relevant income” for football clubs through valuable young players, increased attendances and new sponsorships in the future.

b. A lot more money will be generated internally through the football business if managers that face hard budget constraints stop playing infinite moral hazard and rent-seeking games and simply do “a good job”, concentrating on productive efforts, taking adequate risks in their factor and product markets, etc.

\(^{41}\) Let’s bear in mind that even such „inflated“ owner payments into payrolls are still allowed up to a level of € 45m in the current monitoring period.
c. Finally, “normal investment” will come (or come back) into football, if the “zombie race” can be stopped and football clubs cease to be money traps.

3. HOW “RESTRICTIVE” IS FFP IN “NORMAL” BUSINESS CONTEXTS, AND ARE SALARY CAPS THE RIGHT BENCHMARK?

Peeters and Szymanski (2012) present an interesting paper, in which they interpret FFP as a vertical restraint. Based on results from a structural model, they argue that FFP brings downward pressure on wages just like a US salary cap does. However, FFP fails to deliver the compensating benefit usually claimed for a US salary cap: higher competitive balance.

A. Why FFP Is A Very “Tolerant” Restriction Of Competition, If At All

Can we really interpret FFP as a restriction of competition comparable to a US salary cap? Even if it is correct that FFP brings downward pressure to salaries in the current financial situation of European club football, we still have to ask the following question: In what sense does FFP restrict competition measured against a “normal” business context?

Simply put, FFP says to owners of football clubs: “Don’t spend more on your payroll than your football revenues plus a deficit of € 5m plus a maximum of € 40m injectable from your own fortune in every monitoring period!” If we would tell, for example, the owner of a brewery or a construction company that he may spend all his revenues plus a deficit of € 5m plus € 40m from his own fortune as compensation for his employees, would this be perceived as a restriction of competition? Does “proper” or “genuine” competition require that businesses spend more on their payroll than their earnings plus an acceptable deviation plus a still possible maximum amount injected by the owner? Are all the firms and businesses in other industries that break even or even make profits examples of “restricted competition”? FFPformulates a rule that seems quite reasonable for every business “out there”. Compared to US salary caps, which restrict payroll expenditures at around 50% of league revenues, FFP

42 Although the qualification of FFP as a vertical restraint is very doubtful, I will not take up this discussion here. Budzinski (2012) gives an in depth analysis of the framework employed by the European Commission to classify competitive interventions of sports governing bodies as horizontal or vertical restraints. It seems to me that the framework, which has been, for example, employed in the broadcasting rights cases, can easily be applied to FFP with quite similar results.
seems to be a very “tolerant” restriction of competition, one that would not be binding in any “normal” business context.\textsuperscript{43}

Because the football “zombie race” cannot be compared to a “normal” business context at the moment, I entirely agree with Peeters and Szymanski (2012) that FFP will be binding for some football clubs and therefore put downward pressure on salaries. But this is only a temporary phenomenon. If FFP works in the direction described in Section 2, restoring incentives for “good management” in football clubs, then new revenues will be generated, which in the end could allow the payment of even higher salaries than in the current system.

**B. Why Salary Caps Are The Wrong Benchmark**

Because US salary caps define a uniform maximum level of payroll expenditure for all teams in a league, they allegedly improve competitive balance and increase the attractiveness of the competition. Thus, US salary caps have a benefit, which may offset the anti-competitive intervention in the player market. Peeters and Szymanski (2012, p.7) are entirely right that the break-even rule does not define a uniform maximum level of payroll expenditure for all teams in a league. Therefore, the benefit claimed for US salary caps, more even competition through uniform maximum payrolls, cannot be attributed to FFP.

This diagnosis raises two questions: Should UEFA better introduce a salary cap instead of FFP? Could it be the case that by comparing FFP with salary caps the potential of FFP to generate more suspense in the open European football model is not fully recognized or perhaps even misconceived?

Due to its obvious connection to the ossification of hierarchy critique, the second question will be treated extensively in section 4. Taking up the first question, it seems somewhat surprising that so far not a single football league in Europe has voluntarily followed the American example and voted for absolute salary caps. Assuming that not all the stakeholders

\textsuperscript{43} UEFA’s regulatory interventions are of course always limited by the threat that clubs vote for exit and create an alternative American style “European Super-Soccer League”. However, it seems very unlikely that FFP should initiate this kind of movement. Those owners who want to break away because they cannot inject more than € 45 m from their private fortune into payrolls in the monitoring period have no reason at all to dream of some sort of European soccer NFL. For good economic reasons, which are explained below (securing competitive balance as the sole concept that gives meaning to games), all existing US closed shop leagues operate with much more restrictive payroll regulations.
of football in all European countries can have been simply ignorant, two alternative answers come to mind: Either European football is based on more complex mechanisms of suspense generation than the US leagues or competitive balance regulation via absolute salary caps is simply not possible to implement in the European system. A closer look reveals that both could be true. 

Many concepts to give meaning and add value to single games
Only in the closed-shop US leagues, staging the same teams year after year, “forever”, is competitive balance in the narrow sense of “closeness between perennial competitors” the sole concept that gives meaning and adds value to single games. In contrast, the open European system has many concepts that give meaning to single games. The suspense of the championship race in every league of the entire system is supplemented by the suspense generated by other “crucial fights” (achieving promotion, avoiding relegation, qualifying for the UEFA Champions League or UEFA Europa League, etc.). While in May 2013 the international world of football was preoccupied with the “German final” of the UEFA Champions League at Wembley between Bayern München and Borussia Dortmund, the German stadia and media were staging the last scenes of the drama “Abstiegskampf”, the fight against relegation, in which every single game was deciding the fate of teams, coaches and players. No single fan in these sold-out “games of fate” and no single TV viewer cared at all about the closeness between the desperately fighting underdogs and the champion Bayern München.

Endogenous competitive balance through filtering needs a certain level of imbalance as “input”
Bayern München may have been stronger than other teams in the Bundesliga last season, but as a result it has the chance and duty to compare with more competitive teams from the other national European leagues like Arsenal, Manchester United or Barcelona in the UEFA Champions League this season. At the same time, teams like Düsseldorf and Fürth, which did not prove competitive in the first division last season, have to play against weaker teams in

I am aware of the existence of very elaborate competitive balance discussion in the field of sports economics (see Pawlowski (2013) for a recent state-of-the-art treatment). It is not my intention at all to embark on this discussion. The point of departure for me is the widespread expectation that UEFA FFP “should do something” about competitive balance (see e.g. Vöpel 2011).
the second division this season. Sending Bayern to the Champions League and relegating Düsseldorf and Fürth to the second division makes sure that all of them will play games against better matched competitors in the future. Such games against competitors of comparable strength are an endogenous result of the filtering system central to European football. They do not have to be created by additional regulation like in the US case. In other words: Because European football is designed as a “multi-level filtering device” it can not only deal with competitive imbalance, it even needs a certain level of competitive imbalance in order to perform its filtering function. The filtering function is at the core of the European football show, offering a whole range of “crucial fights” to the spectator.

League redesign would be necessary before absolute salary cap regulation could be effective

European club competitions are played by teams that simultaneously compete for the league championship in their extremely heterogeneous national markets. Whereas the total revenues of the clubs competing in the Premier League reached a level of € 2.7bn in 2011, the clubs competing in the Estonian League earned perhaps a thousandth of this sum. If UEFA would pursue a strategy of implementing a US-style absolute salary cap in European club competitions in order to increase competitive balance, what would be the right level: The level ensuring close competition among the clubs of the Estonian national league, or the level securing competitive balance in the Premier League? While the level suitable for close competition in the Estonian league would presumably drive the rest of Europe to break away from UEFA and organize alternative competitions, the level suitable for close competition in the Premier league would go entirely unnoticed in most of Europe and have no effect whatsoever on the closeness of competitions in the respective national leagues. Or should each national league, instead of UEFA, cap salaries at a level reflecting its specific domestic revenue potential? In this case European competitions would take place among teams officially capped at different salary levels reflecting different domestic regulations. This is not only detrimental to the attraction of European competition, but it also raises various incentive problems. For example, if teams win prize money that they are not able to spend on players in the future because of their domestic regulations, why should they even participate?

The idea of absolute salary cap regulation applied to all participating clubs presupposes either a single-league setting in a common product market (the US model) or a series of rather homogeneous leagues operating in different product markets but with comparable revenue potential. Both concepts – the creation of a closed European league of top clubs and the transformation of heterogeneous national leagues into regional leagues of comparable market
size – have been discussed extensively in the literature (e.g. Hoehn and Szymanski 2001), but have never been transformed into practice. As long as the European top clubs prefer to play European competitions and national championships simultaneously instead of entirely breaking away to form a US-style European league, and as long as the smaller national federations do not join efforts to create larger regional leagues, European competitive balance regulation via absolute salary caps is not feasible.

Quite obviously, salary caps are an American solution for an American problem. Neither are they applicable in the open European football model, nor are they the right benchmark for assessing the potential of FFP to generate more suspense in the open European football model, as is further shown in section 4.

4. THE DANGER OF “OSSIFICATION” – WHY “MONEY COMES TO MONEY” WITHOUT FFP AND WHY RESTORING INCENTIVES FOR “GOOD MANAGEMENT” IS ESSENTIAL FOR “SHAKING FOOTBALL HIERARCHIES”

Since even the richest club benefactor will have to compete based on payrolls largely financed through income generated in the football market after the introduction of FFP, he will no longer be able to challenge all the “bigger clubs” in the football hierarchy by simply spending more money on players, despite having the personal financial means to do so. The idea that FFP might therefore entrench the dominance of already “big clubs” has become quite popular both in sports economics45 and in the media46.

Obviously, this “ossification of hierarchy” argument assumes that “small clubs” can only or can better challenge “big clubs” in a system of unlimited money injections. However, this seems unlikely for two reasons: Firstly, there is no mechanism, which systematically allocates payroll injections according to a pattern that makes “small clubs” relatively more competitive. In reality, it is much more plausible that a sort of inverse mechanism is at play, making sure that “money comes to money”. Secondly, it becomes even more doubtful that unlimited money injections are an instrument for shaking established football hierarchies, once the incentives for “good management” are properly taken into consideration.

46 See e.g. Thompson (2013), Daskal (2013).
A. Why “Money Comes To Money” Without FFP

We should recall first that FFP only caps “inflated” owner payments above the fair market value of goods/services exchanged with the club. A sponsoring agreement, where the owner pays a fair market price in exchange for the exposure/image transfer generated by the team for his other businesses, is in line with the regulations. In order to be affected by FFP, the owner must obviously be willing to inject more money into payrolls than the publicity generated through the success of his team. Such benefactor-owners pay for success per se. In other words: Those owners that will be restrained by the new regulation in their “usual” spending behavior are by definition more than just publicity-seekers, they are genuine success-seekers.47

Second, it is widely accepted that the behavior of European football clubs is best described as “win maximization subject to a zero profit budget constraint”48. While this view has been developed and elaborated based on theoretical models (e.g. Kesenne 1996, 2000) first, Garcia-del-Barro/Szymanski (2006) provided supporting empirical evidence using data on the performance of football clubs in Spain and England. Put simply, this objective function suggests that European football clubs tend to spend their entire revenues in order to be as successful as possible on the pitch. Moreover, it suggests that the clubs will welcome and invest in additional wins every other increase in spending power originating from “external sources”.

Which is the likely result of a matching process between success-seeking benefactors and win-maximizing clubs? In league competition, favorites (clubs with big market potential) will not wish to lose against “supported underdogs” (clubs from smaller markets but with benefactor payroll injections). Therefore, they will increasingly adapt their governance structures and open their doors to benefactors. Since success-seeking benefactors by definition will try to spend their money where winning probabilities are highest and win-maximizing clubs by definition prefer the largest payroll-injection, in the end the benefactors with the deepest pockets get allocated to the clubs with the largest market potential (the

47 Apparently, it is possible to construct various rational explanations for genuine success-seeking. At a very basic level, it suffices to assume the existence of wealthy individuals with a preference for success in international football. If we imagine a very rich man dreaming to win the Champions League with his football club more than anything else, willingness to buy success on the pitch follows by assumption.

favorites), making them even more dominant. Therefore, in equilibrium unlimited payroll injections very likely contribute to the ossification of the football hierarchy.\footnote{Obviously, not all doors at European football clubs have been opened for benefactor-owners so far. Some well-run “big market clubs” have presumably not yet felt intense enough competition from sugar daddy supported clubs. In the meanwhile benefactors have walked through the “first open doors” at the “biggest clubs” available for them on the market for corporate control. Clearly, competitive pressures have increased for clubs like Madrid, ManU, Barcelona, Arsenal and Bayern that so far do not rely on the support of sugar daddy owners. However, the supporters of unrestrained payroll injections should recognize that this is only a transitory stage before all doors of the European “big market clubs” will become wide-open to benefactors. Success-seeking benefactors will be happy to walk through the doors in Madrid, Barcelona, Munich etc., once they are open to them. And why should Madrid, Barcelona, Munich etc. not open their doors for benefactors and instead accept to constantly loose against clubs that from their perspective are “supported underdogs”? The failure of FFP would certainly accelerate this transition towards “open doors for benefactors”. After the transition the deepest pockets will back the clubs from the “biggest markets”, entrenching their dominance.}

Against this background, FFP reduces the gap between favorites and underdogs by forcing all clubs to operate within their market potential instead of allowing favorites to boost their salaries with the largest subventions given to them by the richest benefactors chasing after sportive success. Compared to a US salary cap FFP may not define a uniform payroll ceiling for all clubs, but it contributes to more intense competition by breaking the “money comes to money” equilibrium, where in the end the deepest pockets would get attached to the clubs with the largest market potential.

\textbf{B. Why Restoring Incentives For “Good Management” Is Essential For “Shaking Football Hierarchies”}

Moreover, by breaking the described “money comes to money” dynamics, FFP brings the football hierarchy closer together again. As a consequence the relative importance of “good management” for sporting success increases. A well-managed “medium sized club”, like e.g. Borussia Dortmund, can seriously hope to at least temporarily outperform a “big market club”, like e.g. Bayern München, whenever the latter is poorly managed and/or unlucky. There would be less hope for Dortmund to beat Bayern based on “better management” if the usual advantage of a bigger market for Bayern would be systematically amplified through the additional advantage of a bigger benefactor for Bayern.
By preventing that the deepest pockets inflate the payrolls of the clubs already situated in the largest markets, FFP revitalizes the importance of “management quality” as an avenue for achieving sporting success. European football will profit from the contest in “management quality”. This contest will strengthen a source of variance in the football hierarchy, which has been at least partially buried in the times and leagues where “pleasing benefactors” came first.

5. CONCLUSION

Analyses of regulation that do not look at how regulation affects managerial decision-making miss the main point of regulation. Who would, for example, look at banking regulation without considering its effects on the incentives of bank managers to engage in moral hazard and rent-seeking? This is what banking regulation is all about. The same standard should be applied when analyzing the likely effects of football regulation.

This paper has tried to analyze how managers and decision-makers in football clubs will presumably react to the harder budget constraints introduced through FFP. The critics of FFP focus on the “missing money” from capped benefactor injections into payrolls and predict a downturn and an ossification of the football industry. But can we seriously forecast the level of future player salaries and the intensity of competition without considering the effects of changed managerial incentives? I do not think so.

After the introduction of FFP managers will have to run clubs based on budgets that stay within the hard limit drawn by their football income and the “acceptable deviation” defined in the FFP regulations. By introducing hard budget constraints FFP restores the incentives for “good management” in an industry that has degenerated to a “zombie race” with an ever-increasing number of technically bankrupt participants, which rely on getting rescued by state subventions and/or private money injections year after year. While it is not even a declared objective of FFP to increase competitive balance, it is nevertheless the case that FFP prevents further entrenchment in the football industry. In other words, FFP not only protects systemic financial stability but it does so with a positive side effect for the preservation of suspense in the open European football system.
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