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CASINOS, LOTTERIES, AND MARKETS

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The essence of gambling consists in an abandonment of reason, and inhibition of the factors of human control... A practice so corrupting to the intelligence not only of the habitue', but even of the casual spectator, stands condemned as a formidable enemy of education and intellectual order.

John A. Hobson, 1905 The Moral Philosopher

There is no place for legalized gambling in an enlightened society.

Virgil W. Peterson, 1951 Director of the Chicago Crime Commission

ABSTRACT

Gambling activities of casinos, lotteries and other forms are becoming increasingly acceptable to society. Also, the media and the public are increasingly referring to economically essential market-risk management activities like trading in derivatives as gambling. This paper attempts to distinguish between these two types of activities and maintains that unlike gambling in casinos and lotteries, the market-risk management activities add value to the economy and are essential to the efficient working of production and distribution functions of the economy.

I.

Gambling has been a constant feature of all societies, ancient as well as contemporary. (Clotfelter and Cook, 1989) People have been playing money-games even before they started playing ball-games. Lotteries, as one form of gambling have been with us ever since the Romans concocted the first one! ("Lottomania", 1989) Gambling has always enticed a substantial proportion of the population regardless of their social, economic, or political status. It has even aroused a wide interest among the non-gambling population. Yet, in spite of all this popularity, until recently, gambling was always considered by society as unacceptable, unethical, unproductive and a bad influence on morals and the work ethic! ("Gambling Fever", 1989) However, in the late twentieth century gambling seems to be not so unacceptable to society. It is being widely legalized and thus becoming legitimized! (Clotfelter and Cook, 1989)

The change in societal attitude towards gambling and the increasing popularity of gambling in the U.S. is, probably, due to:

- i) government sponsoring gambling activities like lotteries which has given legitimacy to legal and illegal gambling.
- ii) significant de-skilling of the gambling activities which has made it easier for the general population to participate.
- iii) easy accessibility of gaming devices/opportunities to the general public in many walks of life; e.g., the presence of self-service lottery ticket machines in the grocery stores.

Thus it is no surprise that a large percentage of the public (approximately an estimated 70%) is participating in some form of gambling in the U.S. (*The Wall Street Journal*, 1993) To quote from *The Wall Street Journal* (10-22-1993):

“The wave of wagering stems from municipal penury combined with changing morality. Americans are so eager to gamble that they are shifting their leisure-time expenditures, Last year they spent more on legal games of chance than on movie theaters, books, amusement attractions, and recorded music combined.”

According to industry experts, spending on gambling is expected to double within a decade as the number of riverboat casinos, card clubs, and off-tack betting parlors is fast increasing. There will also be more casinos run by Native Indians because the Indian Gaming and Regulatory Act of 1988 has cleared the way for Native Americans to set up gambling operations as an economic development tool. There are already more than 200 casinos and bingo parlors run by Native Indians. (*The Wall Street Journal*, 1993)

II.

Now, as per gambling industry sources, approximately \$630 billion is wagered yearly in legal and illegal gambling. Most money is wagered in casinos while the majority of the state governments are conducting lotteries that are growing in popularity. In this era of strong opposition to tax increases, lotteries have become an easy way for governments to bring in additional revenues. In 1993, state run lotteries alone took in \$35 billion more than they paid out in prize money! The state governments are not just simply running the lotteries, they are very actively marketing them! In addition, they are enthusiastically welcoming riverboat gambling casinos into their states.

Thus, with hundreds of billions of dollars and millions of jobs, gambling has become an important sector of the economy that has not only the state officials' stamp of approval, but also no significant opposition from society's traditional moral leaders: the church and the intelligentsia. The fact that this sector provides fun activities and jobs should not distract us from the more important problem of addiction to gambling which is a direct result of this sector. Gambling addicts (compulsive gamblers) are estimated to be between 3% to 4% of the participants. A significant portion of these compulsive gamblers commit crimes of all kinds, and some of them end up in jails and become a drag on the economy and society. In addition, another 10% to 15% of the gambling public, though not fully addicted to the level of compulsive gambling, bet more money than they can

afford. These two groups of gamblers account for almost half of all the money wagered. (Thompson, Gazel, and Rickman, 1997) Compulsive gamblers are the best customers of the gambling industry. Hence, not enough interest is shown by the industry to curb this societal disease!

Another disturbing aspect of the gambling sector is that a much greater proportion of poorer Americans participate in these activities compared to more affluent Americans. (Clotfelter and Cook, 1989) The reason for this seems to be that people who are in the financial lower class think they lack real opportunities and qualifications for social advancement and fantasize about winning the jackpot, which they think would be a sure way to fulfill the aspirations for upward social mobility. Symbolically it is very damaging to the work ethic to watch on television the multimillion dollar powerball lottery winners and listen to their accounts of how they chose their winning numbers: birth days, anniversaries, etc. The entrepreneurial spirit, of hard work and discipline have given way to a fantasy of hitting the jackpot. These games of chance where the participant is entirely passive are negations of the work ethic. In a way, many Americans are saying bye-bye Horatio Alger, we think buying a lottery ticket is better than scrimping and saving a dollar.

III.

During the 19th century and the early 20th century, social reformers vigorously lobbied for prohibiting not only gambling, but also restricting and/or prohibiting trading in the futures and options markets as they thought these were also gambling. (Raines and Leathers, 1994)

But, are the futures and options markets merely gambling as some would argue, or are they economically essential risk-management activities?

Economic risks are unavoidable in the normal economic activities of production and distribution. These risks are a result of the fact that all possible outcomes and their probabilities of occurrences are unknown. Some of these risks are insurable and thus can be covered by purchasing insurance. But, some other risks are uninsurable and, therefore, cannot be covered by traditional insurance. The futures and options markets are the only source of shedding these uninsurable risks.

More recently, businesses and individuals are identifying activities where there is a risk that had previously gone unnoticed and unvalued. These risks are not insurable in the traditional sense. Newly developed financial markets are providing options for insuring these previously uninsurable risks. The financial markets are comprised of options and futures contracts. Prior to these markets, for example, a farmer had little control over price, revenues, and subsequent earnings for his crop. Now the farmer has the ability to hedge (enter futures contracts for his crop). This contract establishes a price on which he or she may use to calculate revenues and budget expenses. Therefore, he or she may reduce the uncertainty of their business conditions and exert more control over earnings.

Many critics contend that these markets, especially markets in derivatives, are akin to casino gambling and should be heavily regulated by governing bodies. Conceptually, and in reality, the net outcome to society of markets including trading in financial derivatives and engaging in gambling activities are dramatically different.

An analysis of the macro impact of the two activities reveals significant differences. The markets provide individuals and companies an opportunity to exchange risk. Each individual and company may independently value their risk and determine if the instruments available on the market will help to reduce the identified risk at a cost that is below the calculated cost of uncertainty. These markets are another option for businesses to utilize when engaging in economic activity that inherently involves risk. Properly managed, the market should benefit the business entity regardless of the specific outcome of their contract performance in the market. The market losers are speculators and businesses that are not utilizing the instruments appropriately in meeting their strategic objectives. The speculators have calculated the risk associated with the contract purchased and are willing to bear its opportunity cost.

These markets are a stimulant for businesses to engage in business activity that previously may have had high risks that were uninsurable. The resulting economic activity will lead to a more competitive marketplace with an increased quantity of goods and services. The derivatives markets do punish those that do act irresponsibly or those that consider the gain worth the punishment. The end result is an allocation of resources to those that are most efficient in their management of their identified risks.

In conclusion, risk management is not a gambling activity as some critics claim. The markets provide businesses an opportunity to cover uninsurable risks that allow them to pursue creative business ventures more profitably and with more predictability. The speculators are able to incur the calculated opportunity losses on their contracts as well as benefit from gains when contracts appreciate in value. As with all economic activity there will be those that abuse or misuse the system. These violators will suffer the punishment of the free market which may be swift and severe. But, the net gain to society due to these stocks, futures, and options markets providing risk management opportunities to the economy are definitely positive.

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