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Gambling

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Gambling is an activity in which a consideration (something of value) is paid in return for a hopedfor prize (also something of value), the acquisition of which is contingent upon chance (the outcome of a random event). The elements of a lottery and gambling are the same, so that legal prohibitions against lotteries are also prohibitions against wagering and gambling. Investment activities, also involving risk, differ from gambling because investors avoid risk where possible and earn a positive net return on average. In the United States, all states had criminalized gambling—threefourths by constitutional provisions—by 1910. The only active gambling was horse racing on a few tracks in two states. Nevada reversed itself to allow casinos in the 1930s, as did other states in the 1990s.

If not for harmful externalities and associated social costs caused by gambling (that is, if A's decision to gamble imposes costs on a noninvolved party B, then B has standing and an interest in the regulation of gambling), there would be little reason for attention to the subject as a *legal* or *public* matter. Nevertheless, there are several curious and interesting sociological features:

- Gambling appears to be as old, or nearly as old, as recorded history.
- Across different times and cultures, God was believed to determine, or be able to intervene to determine, the outcome of random events and thus, in the right circumstances, random events could be used as a way to discern God's mind.
- Behavior toward risk appears to adhere to relatively invariant norms intrinsic to humans throughout history.
- The study of probability and statistics, on which the field of modern finance rests, had its origins in gambling and the desire to understand random outcomes.
- Gambling has historically been used by its promoters as a vehicle for fraud and customer scams.

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Value and Probability

The starting point for understanding the public stance on gambling is the concept of a fair bet. A fair bet is any gamble which, if repeated an infinite number of times, would cause the bettor to neither gain nor lose. Betting $1 that heads will appear on the flip of a coin, which turns equally heads or tails, causes the bettor (who receives $2 if heads appears and receives $0 if tails appears) to neither gain nor lose if it is infinitely repeated. The average outcome of an infinitely repeated gamble is its expected value. The *law of large numbers* (the observation that the average outcome of a large number of independent identical trials deviates from the numerical expected value of the gamble by an inconsequential amount for a large enough number of trials) implies that the bet on the coin would win half the time. The coin flip expected value is $E = 0.5 \times \$0 + 0.5 \times \$2 = \$1$, which equals the bettor's payment for the chance to gamble.

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Gambling promoters know that their patrons are willing to pay more than a gamble is worth and that more complicated gambles involve harder-to-calculate expected values. The willingness to accept unfair bets, coupled with the law of large numbers, allows gambling promoters to make essentially riskless profits.

The Scottish thinker, writer, and founder of economics Adam Smith (1723–1790) wrote, in *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776), that in state lotteries, people often pay up to a 40 percent premium on tickets, whose price exceeds their fair value.

These and higher premiums are still evident. If p is the ticket price for a simple lottery, n the number of subscribers, and fraction t of the proceeds is removed by the promoters before the remaining pool is paid to the winner, then the expected value of a lottery ticket is $E = (1/n)\ (np - npt) + (1 - 1/n)\ 0 = (1 - t)\ p$. The advance over fair value in percent is $100p/E - 1 = 100t/(1 - t)$. Smith attributed the willingness to purchase unfair bets to a natural human tendency. “That the chance of gain is naturally over-valued, we may learn from the universal success of lotteries. The world neither ever saw, nor ever will see, a perfectly fair lottery; or one in which the whole gain compensated the whole loss;

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because the undertaker could make nothing by it…. The vain hope of gaining some of the great prizes is the sole cause of this demand" (1952: 45).

Fraud and Other Social Costs

The difficulty in many circumstances of verifying the probabilities associated with random events makes gambling susceptible to fraud. Promoters are often dishonest, which historically has given gambling a social stigma. Bets on sporting events can provide an incentive for participants to alter the outcome of a contest; unbalanced dice and other scams usually give an advantage to the house. In the twenty-first century, Internet gambling may prove particularly hard even for national governments to monitor.

In addition to attracting fraud, gambling, due to the tendency of some gamblers to lose too much, creates the need for government oversight and restrictions that most other activities do not share. Through much of modern history, laws have prohibited casino gambling and have not enforced gambling debts. Gambling diary studies imply that slot machines derive as much as 60 percent of their revenues from problem and pathological gamblers. The range of revenue from problem and pathological gamblers reported for casinos is a third to a half.

Other social costs are a source of public concern. Many social costs associated with gambling derive from problem and pathological gamblers. The *Diagnostic and Statistical Manual* (DSM-IV) of the American Psychiatric Association identifies pathological gambling as an impulse control disorder. Pathological gamblers commit illegal acts to finance their gambling, exhibit repeated failures to resist the urge to gamble, rely on others to relieve desperate financial situations caused by gambling, and lose control over their gambling, personal lives, and employment. According to the Maryland Department of Health and Mental Hygiene, a study of gamblers in treatment found that 62 percent had committed illegal acts because of their gambling, 80 percent had committed civil offenses, and 23 percent had been charged with criminal offenses. A similar survey of nearly 400 members of Gambler's Anonymous showed that 57 percent had admitted stealing to finance their gambling. The National Gambling Impact Study Commission reported that 21 percent of individuals who had suffered from gambling pathology had been incarcerated, compared with 7 percent of those who did not gamble. The nontechnical term *problem gambler* applies to those with similar problems, but to a lesser degree.

Pathological gamblers frequently constitute 1 to 2 percent of the population and problem gamblers another 2 to 3 percent in areas where casino gambling is available. Las Vegas studies characterize between 6 and 7 percent of the population there as probable problem or pathological gamblers.

Researchers identify several harmful social consequences of gambling. First, crime involves the apprehension of perpetrators and increased police costs, adjudication costs, and incarceration costs. Second, **[p. 621 ↓]** business and employment costs include lost productivity on the job, lost work time, and unemployment-related employer costs. Third, bankruptcy, suicide, illness, and social service costs include therapy and treatment, unemployment, and social services such as welfare and food stamps. Fourth, government direct regulatory costs and family costs include divorce, separation, child abuse, child neglect, and domestic violence. Finally, “abused dollars,” or money obtained for gambling under false pretenses, might involve victims who do not report it as a crime, for example, because the victims are friends or relatives.

By tallying the crimes and associated costs to society of pathological gamblers, one can compute the average crime costs of one additional pathological gambler. Care must be taken to account for multiple causes—an alcoholic pathological gambler's actions may be influenced by more than gambling, for example—and the representativeness of the sample used to identify costs. The methodology can be extended to the other social costs and applied also to the social costs of problem gamblers. Combining social cost data with information on the increased number of problem and pathological gamblers caused by the introduction of gambling generates total social cost numbers. In many cases, costs can also be estimated directly through statistical regression techniques using aggregate economic data.

Benefits

The benefits of gambling are harder to measure. Profits, taxes paid, and persons employed by casinos, for example, are not in themselves benefits. One must take

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into account the effect on profits, taxes, employment, and prices elsewhere in the economy. Conceptually, the benefits of gambling, or any activity, equal the amount that adults would be willing to pay annually for the ability to participate. This value is not the amount that people would gamble, but a payment for the opportunity to gamble. Economic techniques can generate benefit estimates. Current research suggests that the cost-to-benefit ratio of casino gambling is between 3:1 and 5:1, which shows that costs greatly exceed benefits. Pressure for gambling expansion is nevertheless high due to casino promoters' ability to make high profits.

Legal responses to gambling, both tried and contemplated, include prohibition, taxing it by an amount reflecting its social costs, and restricting the ways gambling is offered to lessen the creation of pathologies and the reliance on revenue from pathological gamblers.

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See also

- Cost-Benefit Analysis
- Cybercrime
- Economic Models
- Externalities and Social Costs
- Internet Law
- Risk
- Smith, Adam
- Statistical Inference
- Value

Further Readings

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