

Gambling and Speculation

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Introduction

This paper deals with an important policy issue concerning an individual's economic freedom and social justice. The issue to be studied is related to gambling and speculative business activities. It is argued that since certain "speculative business" practices such as futures trading, speculative practices in the stock market, etc., resemble gambling, they should be classified as a form of public gambling and abolished completely, or else, as a matter of social justice, all public gambling should be legalized so that those individuals not having access to the 'speculative' market could participate in public gambling also.

The following discussion focuses primarily on public gambling, although the arguments presented apply to private gambling as well. Private gambling, as distinguished from public gambling, lacks an entrepreneur, a formal organization, free market (competition among rival entrepreneurs), mass participation and large rewards.

The above policy issue rests on two key assumptions. First, it is assumed that "speculative business" practices and gambling are similar in 'nature' and, therefore, can be treated as the same thing. Second, there is the notion that gambling is socially undesirable and/or immoral; otherwise there would be no legal or religious sanctions against it. It becomes

necessary, then, to probe the validity of these assumptions and to discuss their ramifications for public policy.

First, the nature of gambling is analyzed. Next, the nature of 'speculative' business activities is examined and compared with gambling. Furthermore, an attempt is made to find out what is immoral, if anything, with gambling. After considering these issues a conclusion is reached relative to the legalization of organized gambling.

The nature of gambling

Gambling may be defined as a "reallocation of wealth, on the basis of deliberate risk, involving gain to one party and loss to another, usually without the introduction of productive work on either side" (Fuller and Holliday, 1975). This definition will be used in this paper because it is broad enough to include most common forms of gambling. Two key aspects of the above definition, i.e., deliberate risk and unproductive work are further elaborated.

Risk and gambling

In the following discussion no distinction is made between uncertainty and risk as was introduced by Frank Knight in his book *Risk, Uncertainty and Profit* (Knight, 1921). Knight used the term risk for situations in which the specific outcome of an action is not known because two or more outcomes are possible but the objective probability of each outcome can be determined in advance. Rolling a die is an example of risk in Knightian sense. It was suggested that the term uncertainty be used for situations in which people neither know the types of

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outcomes nor associated objective probability distribution (Knight, pp. 19–21). We will ignore Knight's distinction and use both terms interchangeably. In the present paper risk is viewed as the likelihood that the actual future events (for example, return on investment) will be below expected events.

In all forms of gambling, whether public or private, the element of risk is present. In 'pure' gambling, the player has no control over the outcome of the events, i.e., his skill and familiarity with the game have no impact on the probability of the future events. For example, occurrence of a certain combination in a slot machine or in a roll of dice is determined purely (exclusively) by chance, assuming that the dice (or machine) are not loaded. In some forms of gambling the player's skill or familiarity with the game will influence his success but such skills have no impact on the occurrence of a future event. For example, a skilled backgammon player will play a "double six" (an event) differently than a novice player and thereby affects the outcome of the game. Both players, however, have an equal chance or probability ($1/36$) of getting a "double six." Finally, there are gambling situations in which inside information or skill will have a detrimental effect on the outcome of the gamble. For example, in betting on a horserace a knowledge about the horse, the jockey, or track may result in successful betting. In a game of billiards, physical and intellectual skills are also crucial in influencing the outcome of the game.

An important point to consider is that in all gambling situations the transfer of money (property) among participants is based upon *chance alone*. In other words, the element of chance must be present in the mind of at least one of the players. If all participants were equally well-informed and had symmetrical beliefs about the outcome of the game, no gambling could take place. In the example of horse racing, a bettor may know in advance that all players have 'inside' information about the game. He will, nevertheless, participate in the bet on the assumption that other players' information contains a 'flaw', and provides him a chance to win the bet. Generally, in all forms of gambling the opponents assume that they have an *equal* chance of winning the game. Otherwise, arrangements will be made to equalize the chances. The bet is never made upon the skill of the player but always upon the equality of the chances.

Another characteristic of gambling risk is that it is an artificial risk, i.e., a risk created by the gambling transaction itself. In 'legitimate' business, the risks are inherent to the industry and must be borne by someone if business is to go on. Consider a farmer who can control all productive inputs except the weather. The size of the farmer's crop — depending on nature — is inevitably uncertain. Gambling, on the other hand, represents the creation of risks not previously existing. This point has become, more or less, the official position of the New York Stock Exchange for differentiating gambling from speculative business transactions conducted there. In a later section, it is demonstrated that certain 'legitimate' speculative business transactions also create artificial risks.

Unproductive nature of gambling

For players, gambling, at best, is a zero-sum game, i.e., the aggregate wealth of the players will not be altered due to a gambling activity. The losses of one party are precisely equal to the gains of the other participants. Of course, if the gambling activity were taxed by the government, or there were other 'leakages', then the expected value of winning would be negative, i.e., the aggregate wealth of the players after the play would not be equal to their original wealth.

Although gambling is a sterile transfer of money or goods among individuals creating no new money or goods, it nevertheless consumes the players' time and resources and may subtract from the national income. From a macro-economic point of view, the aggregate wealth of the players will change, in the long run, due to the fact that the transfer of wealth is usually among unequal productive sources. It may be argued that the productivity lost due to a transfer of money from one player will be offset by an increase in the productivity of the other player. This assumption is true only if both the winners' and losers' production schedules were assumed to be identical and linear.

From the preceding discussion it may be concluded that any (business) activity which satisfies the two requirements of gambling's definition, is a gambling activity and, therefore, should be classified as such.