The WAGER Vol. 9(2) – Building a Better Economic Model: Weighing Costs and Benefits of Gambling

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Estimates of the average yearly costs associated with a problem gambler vary over a wide range of $560 to $52,000 (Productivity Commission, 1999). Collins and Lapsley (2003) examined the reasons for such large discrepancies in cost estimates in a recent review. Their paper highlights the difficulties in quantifying the costs and benefits of gambling and offers suggestions for developing reliable psycho-economic impact analyses. This week, The WAGER reviews the basics of their cost estimation strategy.

Defining private and social costs.

When calculating the total economic cost of an activity, Collins and Lapsley point out that it is important to include both private and social costs. They define a private cost as the impact of an activity, undertaken both rationally and with full information as to possible negative outcomes, where the individual bears the total cost of the action. In contrast, social costs are those imposed involuntarily on others in society as a result of the action.

Distinguishing between social and private costs. Confusion among researchers over what constitutes a social cost has led to widespread cost estimation variability in American studies of gambling (Walker and Barnett, 1999).

Collins and Lapsley argue that if any cost condition (i.e., full information, rationality or total individual responsibility) is not met when a private cost is incurred, then an element of social cost exists.

Full information.

A car with a dangerous design flaw illustrates a condition where there was a failure of full information. Collins and Lapsley contend that this represents social costs because the transaction lowered the real wealth of society even though the cost to the owner was an “internal” one: unanticipated consumer losses have widespread economic repercussions (e.g., a corporate book-cooking scandal creates greater economic harm than simply the monetary losses suffered by investors). In the case of gambling, community lack of awareness of long odds in a particular game might incur social costs, because members of that community might not have gambled as much of their savings if they had been fully informed about the low odds of winning and expected rates of return.

Rationality.

While economists might assume that people behave rationally, that is not always the case. Thus, researchers must apply an integrated psycho-economic approach to all methodologies, rather than a strictly economic one. Responsible, legal gambling represents a harmless and relatively low cost pleasure for most individuals. However, Collins and Lapsley warn that when people gamble frequently and intemperately (i.e., irrationally) their actions can result in social costs. Collins and Lapsley provide the following example: gamblers that have lost their jobs continue gambling because
they know that they can always collect social welfare benefits. Identifying the threshold of
rationality has a significant influence on attempts to measure the social costs of gambling.

Individual responsibility.

If an individual does not bear the complete costs of his or her chosen action, then Collins and Lapsley assume that others in society must unwillingly bear any remaining cost.

Attribution of costs.

Collins and Lapsley also recognize the attribution of costs as a confounding issue in many gambling cost analyses. They contend that researchers and economists must be careful to identify costs that are directly attributed to gambling rather than merely costs associated with the behavior but due to some other factor. Also, researchers must make a distinction between costs, versus debts and transfers (i.e. pecuniary costs). For example, some costs borne by members of the community are exactly matched by benefits received by others, resulting in no net costs to society as a whole. Many prior gambling-impact studies have failed to consider these differences, resulting in calculations that support any statement from “gambling is an insignificant problem” to “gambling imposes massive social costs” (Wynne & Schaffer, 2003).

Defining benefits.

In order to determine the total cost of an activity, researchers must also assess benefits since cost is a net concept. Similarly to costs, Collins and Lapsley define total benefits as: private benefits plus social benefits.

Private benefits and social benefits.

As with costs, analyses of benefits vary according to definitions. For example, individuals belonging to particular religions or cultures might not consider certain types of recreation (e.g. gambling) as beneficial. Further, the private benefits of gambling are often subtle. However, just like the theater, sports events or concerts, gambling as a form of entertainment might yield health benefits and reduce medical costs as well as social and recreational benefits. Collins and Lapsley also advise caution when analyzing the social benefits of gambling. Employment, tourism and tax revenue are examples of frequently claimed social benefits. Nevertheless, researchers should always carefully weigh these potential social benefits against counterfactual comparisons. Counterfactual comparisons consider scenarios running contrary to the facts. For example, what would be the economic impact if a particular form of gambling ceased? Would gamblers save their money, spend it on another recreational activity, or both save some and spend some? Each of these conditions would result in a different calculated sum for social benefits.

Solutions.

Collins and Lapsley recognize that it might be impossible to accurately quantify the full range of costs and benefits when analyzing the impact of gambling. However, it is important to gather as much reliable, standardized information as possible to make informed, effective public policies for gambling. To this end, Collins and Lapsley present a framework of recommendations for researchers to follow. First, they stress that gambling researchers must clarify any confusion about underlying theories in cost/benefit analyses and promote discussion of areas where theoretical controversies exist. Next, researchers must establish a theoretical framework for social cost estimation and focus on gathering information to identify and quantify practical, causal relationships between gambling and social problems. Finally, researchers must encourage the creation of broadly comparable bases of international estimates of the social costs of gambling. By addressing these crucial issues, researchers can move towards a better understanding of the costs and benefits of gambling and gain insight to how current gambling policies may affect our society.

Comments on this article can be addressed to Fred Sheahan.

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