Oregon Lottery

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Video Lottery Terminals

• Majority of revenue for lottery
  – 60% of lottery revenue

• Run to maximize revenue
  – Law requirement (ORS)

• Simple economical goal, BUT
  – Political Pressure: maximizing revenue vs. retailer’s “fair rate of return”

• Solution?
Political Fog

• State hires economists and consultants
  – ECONorthwest
  – Audits
  – ORA hires big 6
  – Oregon State Economist

• Both sides are being argued by big $
  – Should not be a political decision (Bias)
  – Economists will be “selective” for $$$
  – Truth: Retailers withhold actual WTP, costs

• We have a better idea…
Theory

• WTP can be revealed through AUCTION
• 1 VLT? Easy.
  – Item gets sold to the highest bidder
  – All auction types (4) get the same revenue
  – Efficient allocation
• 8,000 VLTs? Not so easy.
  – Bidding on commission or license?
  – Duration of license?
  – Urban WTP vs. Rural WTP?
  – How many machines to auction? (Price discrimination)
Our Proposal

• RET’s conclusion
  – Sealed bid-auction is optimal
  – Decreases threat of collusion
  – Oregon is already familiar with it
  – Most importantly: Retailers submit their bids into the hands of the state

• Multi-Unit Auction Setup **
  – Adds some complications
  – Uniform vs. Non-Uniform pricing
Auction Setup

• What do bidders bid over?
  – Flat fee and set inverse commission to cost
  – Like two-part tariff (Efficiency = demand shift)
  – Works perfectly w/ perfect price discrimination.

• Auctions by county
  – Like price discrimination (varying abilities to pay)
  – Reserve pricing (also by county) and decreases threat of collusion
  – Restrict quantity by county (competition)

• Problems: Risk and Optimal Quantity
WVA
Risk

• Retailers inherit more risk
  – Large fee, make up with high commission

• Ways to alleviate
  – license duration – short vs. long - buyout
  – Financing Options?

• Important: Not State’s Responsibility
  – Reasonable to ask retailers here
  – State and retailers are partners…
The Quest for the Optimal Quantity

• What we suggest:
  – Most important if we can’t price discriminate
  – State should run auction
  – Get retailers demand information
  – Gradually adjust to monopolist quantity
  – Do this for all counties (urban / rural split) and likewise for reserve prices
Conclusion

• Political issue is to build support – retailers lose, schools gain.
• Maybe they like that – campaign contributions, political horsetrading.
• Need to design a system that does not cost current retailers too much.
• Gradual implementation, grandfather/veterans clause.
• As auction price increases, surplus from owning a grandfathered machine increases. This makes current retailers support restrictions/ price increases for new retailers!
• Phase out based