

# 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