Chapter 11

Probability – Counting, Betting, Insurance

René Descartes and Blaise Pascal invented the mathematics of probability to answer gambling questions posed by the French nobility in the seventeenth century. We follow history by starting this chapter with simple examples involving cards and dice. Then we discuss raffles and lotteries, fair payoffs and the house advantage, insurance, and risks where quantitative reasoning doesn’t help at all.

Chapter goals:

Goal 11.1. Compute probabilities for games of chance by counting outcomes;

Goal 11.2. Calculate fair price of a bet as a weighted average.

Goal 11.3. Calculate house advantage as (payout)/(income)

Goal 11.4. Understand insurance as a lottery.

11.1 Equally likely

In its everyday qualitative meaning “probably” is just a synonym for “likely” or “I think so but I’m not sure.” In this chapter we start with simple examples where we can make “probably” quantitative by counting the possibilities.

To think about the chance of some particular event involving coins, dice, cards or raffles happening, count the possible equally likely outcomes, then count how many match what you’re looking for and write down the appropriate fraction.

• The probability of heads when tossing a fair coin is \( \frac{1}{2} \).

• The probability of rolling a 6 with a fair die is \( \frac{1}{6} \).

\(^1\)For more on the history, see http://www.math.purdue.edu/~jvataman/0313_001.pdf and http://www.casino-games-online.biz/dice/chevalier-de-mere.html

\(^2\)See comment in instructor’s manual.
11.1. EQUALLY LIKELY

- The probability of drawing an ace from a well shuffled deck is \( \frac{4}{52} \).

In words:

\[
\text{probability of an event} = \frac{\text{number of outcomes that match the event}}{\text{number of possible outcomes}}.
\]

Writing probabilities as fractions helps you remember what they mean. But since they’re just numbers, we can write them as decimals if we wish. Since they are numbers between 0 and 1, we often express them as percentages.

- The probability of heads tossing a fair coin is \( \frac{1}{2} = 0.5 = 50\% \).
- The probability of rolling a 6 with a fair die is \( \frac{1}{6} \approx 0.167 \approx 17\% \).
- The probability of drawing an ace from a well shuffled deck is \( \frac{4}{52} \approx 0.077 = 7.7\% \).

Events that can never happen have probability 0. Events with probability 1 are certain to happen.

- The probability of rolling a 7 with a die is \( \frac{0}{6} = 0 = 0\% \). It doesn’t matter whether the die is fair or not.
- The probability of drawing a heart, a club, a spade or a diamond from a deck of cards is \( \frac{52}{52} = 1 = 100\% \). It doesn’t matter whether the deck is well shuffled or arranged in some nice order.

There are other probability problems you can solve by counting, as long as you’re careful to count the right things.

Many state lotteries offer a prize if you pick the right six numbers in the some range. The numbers must be different, with no repetitions, but the order in which you pick them doesn’t matter. To find the probability that your pick will win you have to count how many ways there are to pick six numbers. That’s a problem for a math course more advanced than this one: the answer is 20,358,520. So the probability of winning pick-six is about one twenty-millionth. If twenty million people play, expect about one winner.

If you pick a state at random, what’s the probability that it has a state lottery? The web site [http://us-lotteries.com/](http://us-lotteries.com/) offers a table showing that 39 states and the District of Columbia had lotteries (in 2012), while three other states participated in multistate lotteries. So the only difficulty in computing the probability is deciding on the definitions we want to use. If we exclude the District of Columbia (which isn’t a state) and the three states that don’t have their own lotteries the the probability is

\[
\frac{\text{number of states with lotteries}}{\text{number of states}} = \frac{39}{50} = 0.78 = 78\%.
\]

That’s just the percentage of states with a lottery.

You have to be careful when you interpret this number. It’s not the same as the probability that a random person in the United States lives in a state with a lottery, because the states without lotteries tend to be smaller than average. To find that probability you would have to count

\[
\text{number of people living in states with lotteries} \div \text{total population}
\]

\(^3\)A private site, not government run, probably reliable for this information.
This is a weighted average of the states, where the weights are the state populations, with a zero for states with no lottery.

We will have much more to say about lotteries in Section 11.4.

11.2 Odds

Another way to describe a coin toss is to say “the odds are fifty-fifty.” Heads and tails are equally likely – the odds are even.

Here are the odds for some gambling events; we usually write odds with a colon (:) and read the colon out loud as “to”.

- The odds for rolling a 6 with a fair die are 1 : 5 or one to five. The odds against are 5 : 1, or five to one.
- The odds for drawing an ace from a well shuffled deck are 4 : 48, or 1 : 12. The odds against are twelve to one.
- The odds for heads tossing a fair coin are 1 : 1.

These examples illustrate how to find the odds for an event when you can count the equally likely possibilities and decide which ones are favorable. You compute

\[(\text{number of favorable cases}) : (\text{number of unfavorable cases})\].

The odds against the event are

\[(\text{number of unfavorable cases}) : (\text{number of favorable cases})\].

Odds are fractions in disguise, so the odds against drawing a spade from a deck of cards may be expressed as 39 : 13 (counting all the possibilities) or simply as 3 : 1 (three to one).

The odds against a winning pick-six ticket are about 20 million to 1.

You can convert back and forth between odds and probabilities. Since the odds against drawing a spade are 39 : 13, the probability that you won’t draw a spade is \(\frac{39}{52} = \frac{3}{4}\). In general, if the odds for an event are \(a : b\) then its probability is \(\frac{a}{a + b}\).

If you start out knowing that you will draw a spade with probability 25\% you know too that the probability that you’ll draw a heart, a diamond or a club is 75\%. With both those probabilities it’s easy to find the odds: they are 0.25 : 0.75 for drawing a spade. That’s just our old friend 1 : 3 in disguise.

In general, if the probability of an event is \(p\) then the odds for that event are \(p : (1 − p)\). The odds against are \((1 − p) : p\).

\(^4\) Grammatically speaking, “odds are” and “probability is”: odds are plural, probability is singular.
11.3. RAFFLES

The few formulas in this section are just common sense. If you understand them you won’t have to memorize them. If you try to memorize them without understanding them you may end up using them in the wrong places. [5]

11.3 Raffles

Simple raffles are gambles with computable probabilities. Tickets are sold, some are chosen at random and the people who hold those tickets get prizes. You may be familiar with fundraising lotteries run by school Parent Teacher Organizations.

Suppose the PTO sells 500 tickets for a raffle with a single prize.

Since each of the 500 tickets has an equal chance of being selected, the odds of a ticket winning are 1 : 499, or 499 : 1 against. The probability that any particular ticket wins is \( \frac{1}{500} = 0.002 = 0.2\% \), or two tenths of a percent.

The probability that a particular person wins may be different. If you buy 10 tickets then you win with probability \( \frac{10}{500} = 0.02 = 2\% \). If you don’t play, the probability is 0. If you buy all of the tickets then you win with probability \( \frac{500}{500} = 1 = 100\% \).

Now let’s connect probability with money, as the French nobles did centuries ago. Suppose the PTO wants to offer a $1000 prize to the winner. Then the fair price of a ticket is

\[
\text{fair price} = \frac{\text{total prize money}}{\text{number of tickets}} = \frac{\$1,000}{500 \text{ tickets}} = 2 \text{ \$ticket}. \quad (11.1)
\]

Using what we learned in Chapter [5] we can rewrite this computation as a weighted average. One of the tickets is worth $1000; the others are worthless, so

\[
\text{fair price} = \frac{\text{total value of tickets}}{\text{number of tickets}} = \frac{499 \times \$0 + 1 \times \$1000}{500} = \frac{499}{500} \times \$0 + \frac{1}{500} \times \$1000
\]

\[
= \text{probability of losing} \times \text{value of losing ticket} + \text{probability of winning} \times \text{value of winning ticket}
\]

\[
= 0.998 \times \$0 + 0.002 \times \$1000
\]

\[
= $2.
\]

In the fourth line of the computation the ticket counts disappear. The fair price is the weighted average value of a ticket, weighted by the probabilities for each kind of ticket.

That average is called the fair price of a ticket because all the money collected is returned in prizes. That may make for an exciting evening at the PTO meeting, but it won’t raise any money. So the PTO decides to charge $3.00 for each ticket, keep the prize at $1,000, and use the other $500 to buy classroom supplies for the kids.

Since the total prize money and the number of tickets have not changed, the fair price is still $2. So on average each ticket loses

\[ \text{cost of ticket} - \text{fair price of ticket} = $3 - $2 = $1. \]

Of course you never lose exactly one dollar with one ticket. You either collect $1000 for a net gain of $997 or get nothing and lose your $3 bet.

Yet another way to calculate the average loss is to see that the prize is just 2/3 of what the PTO collects, so the fair price is 2/3 of the $3 cost, or $2. Then on average each ticket loses the other 1/3, or $1.

Would you buy a $3 ticket when the fair price is just $2, knowing that on average you will lose $1.00? Perhaps. Even though you’re very likely to lose your three dollars you can feel good about supporting the school. Perhaps the thrill you get anticipating what you will do with the prize if you win despite long odds makes the probable loss more bearable.

11.4 State lotteries

We found this quote on the web:

Lotteries rank first among the various forms of gambling in terms of gross revenues: total lottery sales in 1996 totaled $42.9 billion. 1982 gross revenues were $4 billion, representing an increase of 950% over the preceding 15 years, 1982-1996.

Lotteries have the highest profit rates in gambling in the U.S.: in 1996, net revenues (sales minus payouts, but not including costs) totaled $16.2 billion, or almost 38% of sales. They are also the largest source government revenue from gambling, in 1996 netting $13.8 billion, or 32% of money wagered, for governments at all levels. 6

The numbers in this 1996 report are stale, although still useful for explaining important ideas. In Exercise 11.9.10 (page 261) we’ve asked you to update them.

The payoff rules for state lotteries are very complex, and vary widely from game to game. It’s hard to think about the fair price of any particular ticket. But with a little careful reading of the numbers in the quote you can compute the expected average return on each dollar you bet. That number, which will be less than a dollar, is the fair price.

The bookkeeping for analyzing these numbers is

\[ \text{total from ticket sales} = \text{prizes awarded} + \text{overhead} + \text{net revenue to state}. \]

In 1996 gross revenues – that is, ticket sales, dollars bet – were $42.9 billion.

The $16.2 billion in the second paragraph is “sales - payouts”, so the payouts must be $42.9 − $16.2 = $26.7 billion. Then

\[ \frac{\text{payouts}}{\text{sales}} = \frac{$26.7 \text{ billion}}{\$42.9 \text{ billion}} = 0.622377622 \approx 62\% \]

7. One of our favorite words. We don’t know another with three double letters in a row.
so for each lottery dollar in 1996, players got back (on average) a little more than 62 cents in prize money. That is the fair price of a one dollar ticket. The other 38 cents is the 38% of sales that count as total revenue for the government – the $16.2 billion not returned to bettors as prizes. Some of that money was overhead. After subtracting that, the net revenue available for other use was $13.2 billion.

The table at [http://www.census.gov/govs/state/10lottery.html](http://www.census.gov/govs/state/10lottery.html) lists the following data for the 2010 Texas lotteries:

<table>
<thead>
<tr>
<th>Income (ticket sales excluding commissions)</th>
<th>Apportionment of funds</th>
<th>Proceeds available</th>
</tr>
</thead>
<tbody>
<tr>
<td>3,542,210</td>
<td>2,300,182</td>
<td>1,057,048</td>
</tr>
<tr>
<td></td>
<td>184,980</td>
<td></td>
</tr>
</tbody>
</table>

Since \[
\frac{2,300,182}{3,542,210} = 0.649363533 \approx 65%
\]

Texas returned 65 cents on the dollar in lottery payouts in 2010 – three cents more than the national average.

### 11.5 The house advantage

Raffles and lotteries are designed to make money. So is casino gambling – for the casinos. They make a profit, and states tax the proceeds to raise revenue.

Before you lay down your bet at a casino, you should think about how much you will pay to play – the difference between a dollar bet and fair price of that bet (the average amount returned to you for your dollar). That difference is called the house advantage.

In Section 11.4 we discovered that the house advantage on state lotteries is about 35%. At gambling casinos it’s much smaller. As in the state lotteries, the house advantage varies from game to game. It’s the highest (about 10%) for slot machines – and there is no way to know that when you decide to play. But for roulette we can actually calculate the house advantage.

A fair roulette wheel is a circle divided into 36 equal wedges numbered from 1 to 36, colored alternately red and black. A ball runs around the rim of the wheel, slowing down until it falls into a random wedge. Before the wheel spins you place your bet, perhaps:

- on the number 17 (“straight-up”), with a winning probability of \(\frac{1}{36}\). The odds are 35 to 1 against.
- on red, with a winning probability of \(\frac{18}{36} = \frac{1}{2}\). Even odds.
- on odd, at even odds.
- on one of the numbers 1 through 12 (a “dozen bet”), with a winning probability of \(\frac{12}{36} = \frac{1}{3}\). Two to one against.

What would be a fair return on a $1 bet?

- If you bet straight-up the payoff should be $36.
- If you bet on red, the payoff should be $2.
11.5. THE HOUSE ADVANTAGE

- If you bet on odd, the payoff should be $2.
- For a dozen bet the payoff should be $3.

There are several ways to see that these are fair. We’ll work them out with the straight-up dollar bet on a single number.

- Using the technique we learned in Section 11.3, we want to find

\[
\text{winning probability} \times \text{winning payoff} + \text{losing probability} \times \text{losing payoff}
\]

For the straight up bet that’s

\[
\frac{1}{36} \times 36 + \frac{35}{36} \times 0 = 1
\]

which is a perfectly fair average return on a $1 bet!

- Imagine the spin of the wheel as a a raffle with 36 tickets. A dollar bet on 17 is like buying one of the tickets. Imagine that others have bought the other 35 for $1 each. Then the casino has collected $36. The fair thing to do would be to pay that to the winner – then all the money collected is awarded as prizes.

- What happens when you play for a long time? Since you pay $1 for each spin of the wheel and win about \(\frac{1}{36}\) of the time you should collect $36 for each win in order to break even in the long run.

- The odds for winning are 1 : 35. Your $1 bet on 17 is a bet against the casino. They put up $35 to match your $1. The winner takes all $36.

The other computations (to check the fair payoffs for bets on red, or odd, or 1 – 12) work the same way.

In real life the casino must cover expenses, pay the state its share of the take and still turn a profit. So it can’t pay out using the price for a bet. Like the PTO, it must collect more money than it returns in prizes. The average payoff is always less than the cost of a bet. The difference is the house advantage.

In the PTO raffle the organization assumes it sells all the tickets and decides how much of what they collect to return as prizes. But the casino can’t count on people betting on all the numbers, and can’t know how many people will bet.

Figure 11.1: European and American Roulette Wheels

Figure 11.1 shows how they collect the house advantage in roulette. The pictures show two wheels with one or two extra green wedges, numbered 0 and 00. American wheels have both extra wedges; European ones just one.

\footnote{Those wedges are green in the on line pdf. If you’re reading black and white hard copy you need to look harder to find the 0 and the 00.}
11.6. ONE TIME EVENTS

The casino uses the same payoffs: $36 for a winning $1 straight-up bet on 17. But the extra wedges change
the probabilities. Here is the calculation for an American casino:

\[
\frac{1}{38} \times 36 + \frac{37}{38} \times 0 = 0.94736842105
\]

which means that on average you lose more than a nickel of every dollar you bet. The house advantage is just
over 5.25%.

Does this mean you shouldn’t play? Not necessarily. You may be willing to pay the house advantage in return
for the thrill of the gamble. But before you do, you should understand the odds for the game you choose.

There are casino games in which a skilled player can win – slowly, and with great effort. At the poker table
you are competing with other gamblers, not with the house, which pays its expenses and profits by taking a
fraction of the ante or pot on each deal. So the house always wins, but a skilled poker player can win too by
beating the other players.

In principle, you can also win at blackjack. We’ll think about why in the next chapter.

11.6 One time events

In our discussions so far we’ve assumed each example is “fair” (even if payoffs weren’t) – coins and dice and
roulette wheels are properly balanced, decks of cards are properly shuffled, no one peeks when drawing the
winning raffle ticket. In each case all possible outcomes are equally likely so we could compute probabilities
just by counting cases.

To test for whether a particular coin or die is really “fair” you could imagine repeating an experiment many
times. A fair coin should come up heads about half the time (but not exactly half the time, which would be
very unlikely). A fair die should show a 5 about 1/6 of the time. We’ll return to this topic in Section 12.2.

There are many situations in real life where probabilities and odds appear but can’t be computed by simple
counting or checked by repeated experiments. Will the Chicago Cubs win the World Series? Which horse
will win the Kentucky Derby? Who will be elected? Will it rain tomorrow?

Suppose you bet your Chicago friend that the odds against the Cubs winning the World Series are 99 : 1.
You put up $99, she puts up $1 and the winner takes home $100 when the season is over. That means that
(in principle) you believe that probability of that Cubs World Series win is just 1/100.\footnote{Those might be the right odds, since the Cubs haven't won a Series for more than a century (in 2013).}

When lots of people have an opinion they are willing to bet on, they can decide the probability collectively.

There’s a way in which many state lottery payoffs depend on what the bettors think: the total prize money
for a winning pick-six combination is divided among the people who bet on that combination. The odds for
any particular number combination don’t change, but the payoff does. Exercise 11.9.14 (page 263) pursues
this idea.

In horse racing the odds at the track are determined by the bets placed, in what’s called pari-mutuel. Most
readers of this book won’t be playing the horses, and those who do will (or should) know all about this kind
of betting. We discuss it here anyway since it provides an example where we can actually see how the bets
determine the odds.
Before the race the punters place their bets at the tote. After the race the track skims its take or commission – a percentage of the total amount bet. The winning bettors share the remainder in proportion to the amount each bet.

Table 11.2 shows the amount bet on each of six horses in an imaginary race. The horses are real – all winners of the Kentucky Derby – but we made up the numbers.

<table>
<thead>
<tr>
<th>Horse</th>
<th>Bets (K$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Barbaro</td>
<td>239.0</td>
</tr>
<tr>
<td>Spend a Buck</td>
<td>333.2</td>
</tr>
<tr>
<td>Donerail</td>
<td>18.6</td>
</tr>
<tr>
<td>Twenty Grand</td>
<td>904.4</td>
</tr>
<tr>
<td>Apollo</td>
<td>155.0</td>
</tr>
<tr>
<td>Dark Star</td>
<td>66.3</td>
</tr>
<tr>
<td>total</td>
<td>1,716.5</td>
</tr>
</tbody>
</table>

Table 11.2: Race of Champions

The favorite horse is Twenty Grand precisely because more people have bet on him to win.

Since the total amount bet is $1,716,500, the collective wisdom at the track says that Apollo will win with probability $\frac{155,000}{1,716,500} \approx 9\%$. The fair payoff is $\frac{1,716,500}{155,000} = 11.0741935 \approx 11$ dollars per dollar bet.

That corresponds to odds against of about 10 to 1. If Apollo wins, each dollar bet will collect $11$: the original dollar plus the ten the other bettors put up in vain.

We had fun choosing the amounts bet on each of these six horses so that the odds of each are close to their odds in the Derby they won. We’ve included the longest shot of all, Donerail, and a favorite, Twenty Grand, who ran at less than even odds.

The 10 : 1 odds for Apollo do not take into account the race track’s commission. We don’t know how much that was, or even whether it was the same in all six races. Suppose that in this fantasy race it’s 10%.

Suppose Apollo wins. The track pays 90% of the take to those who bet on Apollo – $0.9 \times 1,716,500 / 155,000 = 9.96677\ldots \approx 10$ dollars per dollar, instead of $11$ per dollar. The odds are effectively just 9 : 1 against. The track makes money by lowering the odds, which no longer reflect the probabilities determined by the bets.

The moral of the story: you can win at the race track if you really know better than most people which horse is likely to win. There’s that word “likely” again - you need to know a lot about the horses and play a lot for your knowledge to pay off. Perhaps the best way to win is to sell suckers a system . . . .

### 11.7 Insurance

When you buy insurance you’re gambling. In this case the gamble is one you hope to lose – you don’t want to get sick, or have your house burn down, or total your car. In each of those situations you’ve made a small advance payment you hope and expect to lose in order to cover your losses when a catastrophic event with small probability happens.

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10 “Punter” and “tote” are racing terms. You can look them up if you don’t know what they mean.
Insurance companies estimate probabilities in order to determine the fair price for their policies, then add what they need to cover their administrative expenses and make a profit - their “house advantage.” In the long run, on average, their customers never get all their money back. Therefore you want to think things through when you’re deciding whether to buy insurance for more than the fair price. Sometimes you may be better off accepting the risk yourself.

Here’s a sample of the kind of advice you can find on the web. It’s from Liz Pulliam Weston, writing for MSN Money.

Say you have a 10-year-old Honda that’s worth $4,000 in a private-party sale and have a $500 deductible. Your risk is $3,500. If your premiums for collision and comprehensive are more than $350 a year, it may be wiser to bank that money toward a newer car.

If we make a simple assumption we can think about this using probabilities. Suppose that the only kind of accident to worry about is one that totals the car. Then Weston’s advice is reasonable if you think that the probability that you’ll have such an accident is less than 10%. Here’s why. Imagine that the insurance policy is a lottery ticket, which “wins” if you have an accident. A winning ticket is worth $3,500. If you think you have a 10% chance of winning, then the fair price (for you) is $350. If you think your chance of totaling your car is less than 10% then the fair price is more than $350, so perhaps you shouldn’t buy the insurance.

Of course the real decision isn’t this easy. You should take into account the fact that your accident might not total the car. You have to think about making this decision every year – sometimes your car will be worth more than $4,000, sometimes less. But the principle is clear. If the premiums are very high compared to your estimate of your risk, you should consider not buying collision and comprehensive insurance. Over the course of a driving lifetime you will probably save money.

However, there are often good reasons to pay more than the fair price for insurance. If you don’t have the money to replace a totaled car and you must have one, then you need that insurance. Even if you have the money, the cost to you of a large loss may be more than you can afford, or may feel like more than the dollar amount.

Sometimes you may be required to buy insurance. In order to drive, you must carry liability insurance to cover the cost of injuries to others in an accident you caused. If you have a mortgage on a house the bank will insist on fire insurance to protect their interest in the money they’ve lent you. The taxes you pay to support the police and fire departments can be considered a kind of insurance. You will probably never need their services, but you want them to be there when you do. Healthy people buy health insurance (and may even be required to do so) to spread the cost of catastrophic medical bills.

George Bernard Shaw wrote about this in The Vice of Gambling and the Virtue of Insurance. His essay is well worth reading. You may be able to find it in your library as Chapter 3 of T. W. Korner's Naive Decision Making: Mathematics Applied to the Social World or in Volume 3 of James R. Newman’s The World of Mathematics. There’s a section on health insurance that’s the clearest argument we’ve seen for a “public option.” Too bad it was written a century ago by a socialist.

11.8 Sometimes the numbers don’t help at all

About thirty years ago Joan Bolker had to decide whether to invest three years of hard work in hopes of earning a clinical psychology license.
Only after more than two thousand hours of clinical internships (which she would have to arrange) she could petition to have her doctorate in education count as appropriate postgraduate preparation for the new career. Only if that petition were granted would she be allowed to take the psychology licensing examination, much of which covered material she had not studied in any course.

Clearly the odds were long. She faced a significant investment of time, energy, and lost income, with only a small probability of success at the end. She took the risk. She won her gamble, with a combination of talent, persistence and luck.

The moral of the story: sometimes numbers don’t help. Albert Einstein said

> Not everything that can be counted counts, and not everything that counts can be counted.

In this case there was no way to quantify the costs, the benefits, and the probabilities in order to make what might look like a rational choice. The kind of back-of-an-envelope probability calculations we’ve studied about playing the lottery or buying insurance are often of little help when making life-changing one-of-a-kind choices.

### 11.9 Exercises

**Exercise 11.9.1.** [R][S][Section 11.1] [Goal 11.1] What’s in a name?

(a) What is the probability that the name of a state (of the United States) chosen at random begins with the letter ‘A’?

(b) What is the probability that the name of a state (of the United States) chosen at random begins with the letter ‘Z’?

(c) How much more likely is it that a state name begins with ‘M’ than with ‘A’?

**Exercise 11.9.2.** [U] What you’re counting counts.

(a) What is the probability that a random word in English begins with the letter ‘t’?

This is a question with several answers, which depend on how you select your “random word”. You might find count the words that begin with ‘T’ in the dictionary. You might count those words in a newspaper, or on a website. There may be answers to the question on the web.

Estimate the answer in several ways. Do the various assumptions lead to approximately equal answers?

(b) ‘e’ is the most commonly used letter in English. What is the probability that a random letter in an English text is ‘e’?

Attack this question as you did the previous one.

(c) What is “etaion shrdlu” and where does it come from?

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Exercise 11.9.3. [S][Section 11.1] [Goal 11.1] What is wrong with this estimate?


**TAKE A CHANCE**

New managers often have this quandary: Do you hire the candidate you know is competent, but ordinary, or someone who has the potential to be great, but has an equal chance of being awful?

The advice, from the “Cubicle Coach” Marie Claire, is to go with the wild card.

“You have a 66.7 percent chance of a positive result,” the coach writes. “Yes, the unknown could flop, but she could also a) do as well as the known, or b) actually be a star.”

(a) Explain what’s wrong with this logic.

(b) How do you think Claire determined that an unknown candidate who “has the potential to be great, . . . has an equal chance of being awful”?

(c) What other assumption about “equal chances” does Claire make? On what grounds?

(d) Suppose Claire is correct when she assumes that the probabilities of great and awful are equal. Show that the chance of a positive result (great, or just ok) is somewhere between 50% and 100%.

(e) Make up a similar story in which it’s even clearer that the 2/3 chance is clearly nonsense.

Exercise 11.9.4. [U][Section 11.1] [Goal 11.1] “Probably” in everyday English.

(a) Use the index to this book to find places where we used the words “probably” or “likely” other than in the chapters devoted to studying probability. Discuss the meaning of the word in those contexts. When it makes sense, provide a numerical estimate of the probability.

(b) Do the same for two or three occurrences of “probably” or “likely” in the media.

Exercise 11.9.5. [S][Section 11.1] [Goal 11.1] Possible cut to beach testing a health threat, critics say

In an article in *The Boston Globe* reprinted from the *Washington Post* on March 4, 2012 you could read that

The average citizen visits a coastal shore, Great Lake, or river about 10 days a year, according to a federal estimate . . .

About 3.5 million people each year get sick enough to be nauseated or get diarrhea after splashing in water containing harmful bacteria, according to an Environmental Protection Agency estimate.

What is the probability that a visit to the beach will make you sick?

Exercise 11.9.6. [S][Section 11.2] [Goal 11.1] It’s a horse race

Use the data in Table 11.2 to compute
(a) The odds and payoff for Donerail, the long shot.

(b) The odds and payoff for Twenty Grand, the favorite.

(c) The payoff for these two horses if the track takes a 10% commission before paying off any bets.

[See the back of the book for a hint.]

Exercise 11.9.7. [S][Section 11.2 ] [Goal 11.1] Should I Buy a TV Extended Warranty?

What is missing from this quote from http://tv.about.com/od/warranties/a/buyexwarranty.htm?

Only you can decide if you should buy an extended warranty. Points to consider before buying an extended warranty include:

1. Value of item being purchased
2. Price of extended warranty
3. Length of manufacturer’s warranty
4. Length of extended warranty and date coverage begins

Exercise 11.9.8. [S][R][Section 11.3 ] [Goal 11.2] Which average?

In the raffle discussed in Section 11.3 there are 500 tickets and a $1000 prize. We found that the average value of a ticket was $2.

(a) Which average is that – mean, median or mode?

(b) Compute the other two “average” ticket values.

Exercise 11.9.9. [S][R][Section 11.3 ] [Goal 11.2] Multiple prizes

Suppose a lottery with 1,000,000 tickets has a first prize of $100,000, three second prizes of $30,000 each and 100 third prizes of $100 each.

(a) What is the probability that a ticket wins the first prize? What are the odds against?

(b) What is the probability that a ticket wins some prize? What are the odds?

(c) What is the fair price of a ticket?

(d) If tickets cost a dollar, what is the average value of a ticket?

Exercise 11.9.10. [U][Section 11.4 ] [Goal 11.2] 1996 was a long time ago

The quotation that starts Section 11.4 comes to us courtesy of the University of North Texas CyberCemetery:

The University of North Texas Libraries and the U.S. Government Printing Office, as part of the Federal Depository Library Program, created a partnership to provide permanent public access to the Web sites and publications of defunct U.S. government agencies and commissions. This collection was named the “CyberCemetery” by early users of the site.

http://govinfo.library.unt.edu/
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Update the numbers from that quote (go back to Section 11.4) so that you can rewrite the paragraph referring to a much more recent year than 1996.

[See the back of the book for a hint.]

Exercise 11.9.11. [U][Section 11.4] [Goal 11.2] Your state lottery

What is the average return on a dollar bet in your state lottery?


- From www.masslottery.com/wherethemoneygoes.html

  Last year [2006] the Massachusetts State Lottery distributed over $761 million in Direct Local Aid to the Cities and Towns of the Commonwealth.

- From www.masslottery.com/about/faq.html

  What happens to the revenue which the Lottery generates from sales?
  Revenue generated from Lottery sales is used for three purposes.
  1. A minimum of 45% of revenues stays in the State Lottery Fund to be paid out in prizes. Currently, the Lottery’s prize percentage is over 69%.
  2. A portion of revenues is transferred to the Commonwealth’s General Fund for the expenses incurred in administering and operating the Lottery. The administrative and operating expenses of the Lottery are appropriated by the legislature as part of the annual state budget. Operating expenses cannot exceed 15%. Currently, operating expenses are under 8%. These operating expenses include 5.8% in commissions and bonuses paid to the sales agents who sell the tickets and under 2% in administrative expenses due to Lottery operation.
  3. After prizes and expenses, the remaining Lottery revenues (approximately 23%) is transferred to the Local Aid Fund and returned to the cities and towns of the Commonwealth in the form of local aid.

(a) What was the total dollar amount collected by the Lottery Commission on 2006?

(b) How much did the average citizen spend on lottery tickets?

(c) What is the "fair price" for a $5 lottery ticket? That is, what would a $5 lottery ticket cost if all the money collected from ticket sales was returned to ticket holders as prizes.

(d) Use Excel to draw a pie chart showing how the money collected by the Lottery Commission was distributed among the three categories Prizes, Overhead, Aid to Cities and Towns.

(e) On January 5, 2011 The Boston Globe reported that

  Massachusetts lottery agents have sold about $26 million in tickets over the course of this 16-draw series, which has failed to produce a jackpot winner. The tickets have raised $11 million for cities and towns. [16]

Are these figures consistent with the 2006 information?

Exercise 11.9.13. [S][Section 11.4] [Goal 11.2]  
Megabucks plan rankles lottery players.

The first two paragraphs of an article in The Boston Globe on March 21, 2009 said that

Like anyone who plays the lottery, Dean Thornblad was hoping to get rich quickly. He studied the odds of winning the various games before shelling out $150 for three season tickets that automatically enter him in twice-weekly drawings of Megabucks. At 1 in 5.2 million, the odds of hitting the jackpot, long by any standard, seemed to him at least “somewhat imaginable.”

But even his boundless optimism is being stretched by the lottery’s latest proposal. The agency, under mounting pressure to return more money to cash-strapped cities and towns, is planning to make the odds of winning even slimmer, reducing them to 1 in 13.9 million beginning May 2, by making players match six numbers between 1 and 49, instead of six between 1 and 42.

What has happened to the expected value of Thornblad’s ticket?

Exercise 11.9.14. [S][C][Section 11.4] [Goal 11.2]  
Uncommon numbers

In many state lotteries the customer picks the numbers she thinks will win. The prize is then divided among all the people who happened to pick the winning numbers. Much as we try to analyze only real situations, the real Massachusetts lottery is too complicated for this class. (Many people find it too complicated to choose the numbers they want to bet on, and elect ”quick picks” instead.) So this question is about an imaginary lottery.

Here is how our lottery works. Tickets cost $1. Each person buying a ticket chooses the number between 1 and 100 that she thinks will win. When all the tickets have been sold, the state picks a number at random between 1 and 100. All the people who have chosen that number divide 70% of the total collected among themselves. (The other 30% the state uses for overhead and local aid.) So the fair price for a $1 ticket is $0.70 or 70 cents.

Of course the winners collect much more than the fair price (since the losers collect nothing). For example, if 1000 people bought tickets, 39 was the winning number, and 8 people chose 39, each would get $1000 \times 0.7 / 8 = $87.50.

If everyone buying tickets used ”quick pick” then the 1000 tickets would (more or less) consist of 10 for each of the 100 numbers, ten people would have the winning number and the typical payoff would be $1000 \times 0.7 / 10 = $70.

Now that you’ve read this far and understood the game, we can ask an interesting question. Suppose you know that people are so afraid of the number 13 that no one ever picks it. You think (correctly) ”If I buy a ticket and choose 13, I’m probably not going to win. But if I do win, I will win big because I won’t have to share the prize.” So every day you buy one of the 1000 tickets, and choose 13, knowing that no one else will. You lose with probability $99/100 = 0.99 = 99\%$ and win with probability $1/100 = 0.01 = 1\%$.

In the long run, how much money do you win (on the average) each day?

[See the back of the book for a hint.]

To read more about this idea, check out http://blogs.wsj.com/numbersguy/lottery-math-101-801/ where you will find that

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Low numbers are particularly popular, some of them because birthdays are a popular source of numbers to play. Research conducted by Tom Holtgraves showed that bettors also avoid numbers with repeated digits, though these are just as likely to turn up in lotteries as numbers without.

For still more information, see \texttt{http://www.random.org/faq/#Q3.4}.

\textbf{Exercise 11.9.15.} \texttt{[R][U][Section 11.5] [Goal 11.3]} It’s always 5.26\%

Compute the house advantage with an American wheel for each of the roulette bets discussed in Section 11.5, to show that it’s the same for each bet.

\textbf{Exercise 11.9.16.} \texttt{[U][Section 11.5] [Goal 11.3]} Single zero roulette

(a) Compute the house advantage for a roulette wheel with one extra wedge.

(b) Show that the house advantage in single zero roulette is approximately but not exactly half the house advantage in double zero roulette.

\textbf{Exercise 11.9.17.} \texttt{[U][Section 11.5] [Goal 11.3]} Help this fellow out, please. That is, answer his question at the end.

The roulette wheel has 38 spaces on it (1-36, 0, 00) each with an equal probability of being the winning number. If you bet a number, and that number wins, you get 35 to 1.

So . . . why not bet on 19 numbers. That way you have a 50/50 chance of winning. If the number is not one you bet on, you’re out your bet. If it is though, you get 35 to 1, minus the bets you placed on the 18 other numbers.

Assuming you bet equally on all 19 numbers, this should result in a 50/50 shot of going 17 to 1. (unlike a 50/50 shot of going 1 to 1 if you bet on red/black or even/odd or 1-18/19-36).

Example. Lets bet $1 on 00,2,4,5,8,12,13,15,16,18,21,23,24,25,29,31,32,33,35. You will have a 50/50 chance of going +$35-$18 .... or +$17.

Am I missing something, or is it really that simple? \footnote{https://forums.finalgear.com/off-topic/roulette-strategy-26295/}

\textbf{Exercise 11.9.18.} \texttt{[U] [N]} Playing the Odds on Saving

On January 15, 2014 Tina Rosenberg blogged at The New York Times that

Lotteries aren’t usually considered part of the solution to our savings crisis. They’re usually cited as a big part of the problem. Lotteries offer the worst odds in legal gambling – about 55 percent of what people pay for tickets is paid out in prizes. Yet we spend an average of $540 per household on lottery tickets every year – about $100 more than we spend on milk or beer. That is disproportionately spent by African-Americans, who spend five times as much on lottery tickets per person than whites, and the very poor. People with a household income of less than $10,000 a year who play the lottery spend $597 a year on tickets. \footnote{https://opinionator.blogs.nytimes.com/2014/01/15/playing-the-odds-on-saving/}

Read further for the savings strategy . . .