Lottery Loans in the Eighteenth Century

François R. Velde
Federal Reserve Bank of Chicago

Abstract

In the 18th century Britain frequently issued lottery loans, selling to investors bonds whose size was determined later by a draw. The probability distribution was perfectly known and highly skewed. After the draw the bonds were indistinguishable from other bonds. I collect market prices for the lottery tickets and show that investors were paying a substantial premium to be exposed to this artificial risk. Information about winners indicates that investors were well-to-do and included many merchants and bankers. I turn to cumulative prospect theory to make sense of these observations and estimate the equilibrium model of Barberis and Huang (2008). The preference parameters can account for the level of the lottery premium but not the bubble-like pattern of prices over the course of the draws.