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COMMENT ON BELL ARTICLE

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Almost by definition, all disruptive technologies or innovations threaten vested interests. If markets and the legal environment are sufficiently flexible – and in the United States, for the most they are – innovations that buyers want diffuse throughout the economy despite the opposition.

There are cases, however, where the existing order uses the legal system to fight back, to forestall or delay change. Napster is a case in point: it threatened the established recording industry, which eventually persuaded the courts to shut down that particular form of peer-to-peer file transfer. But even in this case, "the law" has failed to stop innovation. Other peer-to-peer networks have found ways to legally permit free Internet-based file transfers, while some companies – notably Apple – have developed business models around paid file transfer.

As other papers in this volume make clear, prediction markets represent yet another disruptive innovation. Who might they threaten, and will the law get in way?

Tom Bell implicitly, if not explicitly, answers this question in his important survey of the legal issues raised by prediction markets. Both federal regulators and in-house lawyers of major companies that could benefit from allowing their employees to participate in even limited prediction markets, for different reasons, appear to have some anxiety about allowing such markets. Regulators seem to be wary of encouraging speculation, or permitting prediction markets to become vehicles for money laundering. In-house lawyers are nervous of running afoul of various federal securities and commodities trading laws and regulations, overseen by the Securities and Exchange Commission (SEC) and the Commodities Futures Trading Commission (CFTC), respectively. In short, the law indeed is inhibiting the diffusion of prediction markets, and Bell's excellent article explains how.

One obvious way in which federal regulators could improve the legal climate would be to provide a safe harbor for prediction markets that meet certain conditions. This they have done for public markets like the Iowa Presidential exchange: most importantly, the stakes must be small. At this writing, the CFTC also has announced its intention to construct a different safe harbor for in-house corporate prediction markets. Bell outlines in his article some useful principles for the CFTC to follow when it finally gets

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ready to implement this idea. The most important one: keep federal hands off of these markets, to the extent possible.

Even a relatively broad safe harbor from the CFTC, however, may not give in-house corporate lawyers the legal certainty they need to feel comfortable. The CFTC cannot tell the SEC how to exercise its jurisdiction. Further, the extent to which a safe harbor from the CFTC would preempt state gambling laws, especially in this context, may have to be litigated to provide clarity.

One issue which is outside Bell's purview, but which nonetheless also could slow the adoption of prediction markets by corporations relates to organizational behavior. Prediction markets have the potential to have similar or maybe even more profound impacts on large corporations as spreadsheet software once did (and may be still be having). Programs like Excel gave huge power to senior executives who knew how to use it, and thereby threatened the usefulness and ultimately the jobs of large numbers of middle managers whose job was to gather and process information.

Likewise, by harnessing the "wisdom of crowds," prediction markets threaten to trump the judgment of designated "experts" within corporate structures. Those experts understandably might try to resist, either by keeping their companies from using such markets in the first instance, or by finding various ways to sideline or slow the use of those markets if they somehow penetrate the palace gates.

Fortunately, for the companies profiled in this volume, these kinds of corporate roadblocks do not yet appear to have been a major problem. But I suspect that for other companies, they have been or will be. For these companies, even greater legal certainty thus will not lead to greater use of prediction markets.

My guess, therefore, is that if enlightened lawyers follow the advice outlined by Tom Bell, prediction markets will gain surer footing in the marketplace the old-fashioned way: through the force of competition. Companies that gain an edge in the marketplace because of better forecasts eventually should induce others to follow in their wake. If prediction markets don't deliver much benefit, however, then even constructive legal reform can't ensure their use.