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 Print Edition  
 Front Page  
 Front Page Image  
 Inside the A Section  
 ■ Opinion Columns  
 Nation and Politics  
 Editorial Pages  
 World  
 Business  
 Metro  
 Sports  
 Style  
 Previous Editions  
 Sunday Sections  
 The Extras  
 Weekly Sections  
 Subscription Form  
 Nation  
 World  
 Metro  
 Business  
 Technology  
 Sports  
 Style  
 Education  
 Travel  
 Health  
 Real Estate  
 Home & Garden  
 Food  
 Opinion  
 Weather  
 Weekly Sections  
 News Digest  
 Classifieds  
 Archives  
 Site Index  
 Help / Feedback

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## The Furor Over 'Terrorism Futures'

By Justin Wolfers and Eric Zitzewitz  
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Betting on human lives seems ethically questionable. Yet if it helps save lives, surely the moral questions are mitigated. Not so, according to those in Congress (and elsewhere) who created such a furor this week over a planned Pentagon program to project geopolitical risks that the program was quickly shut down. The plan was to use markets to "price" such risks, and it was quickly dubbed a "terrorism futures market." Unfortunately, in hastily ending this program, the government may be closing the door on an important source of information and a promising avenue for research.

The idea was simple: By creating a market in which people can buy and sell contracts that pay \$100 if certain political events occur in the Middle East, we can infer from the price of such securities the probability of these outcomes. By explicitly pricing such risks, we can better understand them and better respond to them.

Financial markets are incredibly powerful aggregators of information, and are often better predictors than traditional methods. The examples are numerous. The futures market in orange juice concentrate is a better predictor of Florida weather than the National Weather Service. The Iowa Electronic Markets outperform the opinion polls in predicting presidential election vote shares. Hewlett Packard ran a market forecasting printer sales that outpredicted any of its analysts. The Defense Department should be applauded for admitting to its own limitations. Last winter we studied a market in "Saddam Securities" that proved to be a good predictor of the probability of war in Iraq.

The reason markets work so well is that they reflect our collective wisdom. And your opinion will be reflected only to the extent that you are willing to put your money where your mouth is.

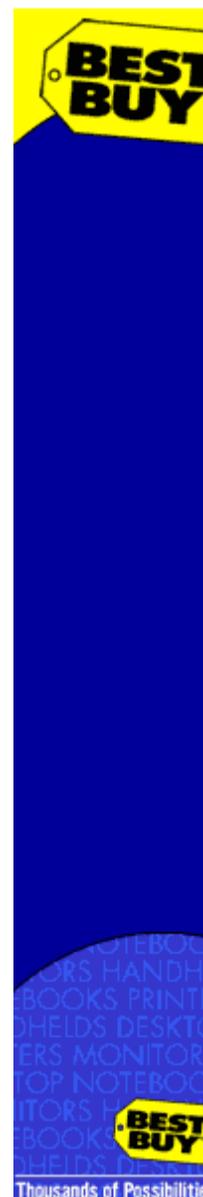
While the joke about military intelligence being an oxymoron is an old one, it bears repeating here. It's no coincidence that we don't have the same doubts about financial markets. Recent events have underscored

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the difficulty of aggregating information from lower levels of the intelligence bureaucracy. Imagine if a "Niger Uranium sale" contract had been trading in January; our guess is that this would have been close to valueless, reflecting the hard intelligence available at the time that such sales never occurred.

Political critics contend that betting on political disruptions not only is distasteful to many but that it also provides an incentive to create political strife, because an assassin might be able to bet that political strife is likely and then go out and cause the strife himself.

But those opportunities and incentives to make trouble already exist. The stock market fell 2.8 percent following President Kennedy's assassination; it fell 4.9 percent following the attacks on the World Trade Center; and the oil markets gyrate wildly with each assassination attempt in the Middle East.

Terrorists determined to profit from their actions can easily buy derivatives to cash in on their actions. Of course they will leave behind a paper trail. But more to the point, all that these prediction markets will do is make the information content of such trading more transparent for policymakers.

A more serious concern raised is that terrorist organizations might trade in the market to create disinformation. But terrorist organizations already have lots of channels for disinformation, and the profit motive in these markets provides incentives for those who know the truth to correct such disinformation. The one thing that economists actually agree on, is that people do respond to such incentives.

Legislatures are not the best institutions for directing research, economic or otherwise. The banished Pentagon program didn't deserve this sort of treatment.

*The writers are assistant professors of economics at Stanford Graduate School of Business. They are co-authors (with Andrew Leigh of Harvard) of a study titled "What Do Financial Markets Think of War in Iraq." Eric Zitzewitz will answer questions about this column in a Live Online discussion at 12 p.m. today on [www.washingtonpost.com](http://www.washingtonpost.com).*

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