

Betting on Terror: Learning from markets.

Online betting exchanges have come under criticism for many things; for undermining the traditional bookmaker's market, for enabling trainers to bet against their own horses, but now they are under fire for inciting acts of terrorism. Earlier this summer the senate became aware of advanced pentagon plans for an online betting exchange to be known as the Policy Analysis Market (PAM), which would allow traders to place money on the market to back their hunches on, for example, the assassination of Yasser Arafat, or a biological weapons attack on Israel.

Live trading was scheduled to start in October, with registration limited initially to 1,000 traders, rising to at least 10,000 by January next year. Traders would have deposited money into an account to win or lose money depending on how well they predicted events. Pam was a joint project of the Pentagon's and two private companies: Net Exchange, a market technologies company, and the Economist Intelligence Unit, part of the Economist magazine.

The story emerged when the Defence Advanced Research Projects Agency (DARPA) the department responsible for pentagon "blue skies" thinking advertised the \$8m scheme on the internet, looking for punters to sign up. In the section about becoming a Pam trader, the website said: "Whatever a prospective trader's interest in Pam, involvement in this group prediction process should prove engaging and may prove profitable."

Senate Democratic Leader Thomas Daschle condemned the scheme as "an incentive actually to commit acts of terrorism." According to California Democrat senator Barbara Boxer. "There is something very sick about it," Another fact set off alarm bells - the Terrorism Information Awareness office, led by Iran Contra veteran Admiral John Poindexter, was involved in PAM's creation and, in the unholy row that has since developed, Poindexter has resigned and the plan has been scrapped

But while the idea of PAM shocked many, there is a strong argument to suggest its results may have been worthwhile. Few can deny there is value in applying the most accurate knowledge to intelligence gathering, and when people they bet they usually bet from the heart. "Polls are one thing", says Sean Boyce, Director of Communications at UK bookmakers Ladbrokes, "but when people bet, where the money goes is often very revealing. People who are prepared to bet fairly large sums, and who wouldn't normally bet, often have very good reasons for doing so."

The fundamental idea behind the policy analysis market is little different to the futures markets that already exist in commodities such as orange juice, oil or wheat. Traders there have to take into account the likelihood of adverse weather or political instability in the Middle East.

This sort of geo-political betting is booming on commercial betting exchanges and fixed odds books. Dublin-based Tradesports.com has been running markets on the survival of both Saddam Hussein and Osama bin Laden since before the war in Iraq.

Political betting markets already account for 25%-30% of their turnover and are the fastest growing sector of business. "Betting on the Saddam contract has drawn in more than \$3m dollars already from 4000 exchange members in 40 countries –making it far wider than a US opinion poll," says John Delaney CEO of Tradesports. "What the Pentagon was attempting to do has some validity," says Delaney "using exchanges as an information aggregator is clearly more efficient than other means. Hewlett Packard already uses an exchange for predicting their sales, so do General Electric."

Historically betting markets have been far more accurate than pools in predicting the outcome of elections. In 1992 the Iowa Political Stock Exchange predicted the outcome of the presidential election, to within one-tenth of one percentage point for each candidate, including the long odds outsider Ross Perot.

Betfair.com the UK-based exchange that now accounts for 90% of online exchange betting has already taken £30,000 in bets on the outcome of the Swedish euro referendum, and has been running a market on who will be the Labour party leader at the time of the next election. "Tony Blair has come in from 10-1 on two months ago, to even money and is now 2-1 on" says Mark Davies, Betfair's director of Communications, "as a measure of public opinion it is very fast to respond."

The American intelligence community has shown itself able to grasp parts of the picture but often spectacularly unable to join the dots and connect disparate ideas. For example the Pentagon knew that al-Qaida was interested in aviation, that it was training young recruits at US pilot schools, and also that it was interested in the World Trade Centre, the earlier underground car-park bomb proved this, but it was not able to connect those random pieces of information

The idea of PAM was to provide another conduit of information for policymakers, and to make connections- so, for example, a sharp drop in the survival price of the Jordanian government could suggest a coup was imminent.

The danger is that those players with real inside information could use the market to make both a literal and financial killing. This is already a possibility in political betting "There is a temptation for an insider to take supernormal profits by laying a bet on a one-off event", says John Delaney, "An insider in Howard Dean's office may know he is about to quit the democratic party selection process, but if the trade looks unusual and is scrutinised it comes straight back to them."

The one part of PAM that has puzzled members of the betting community is how the US govt was expecting to guarantee liquidity in the hundreds of markets it was proposing, to ensure punters who want to bet, have someone to bet against. "There was some reference to automated market making" says Delaney, "but it is hard to see how that could happen without the government taking a position itself." Nevertheless most people with experience of futures betting believe that the policy analysis market could have been a useful predictive tool.

David Ignatius, a liberal commentator at the Washington Post, argued: "For all its defects, the political futures market was an interesting, unconventional idea for capturing information that's "on the street" - the subtle tips and clues that ordinary people know, but that are often lost to our intelligence agencies." Journalists have known since Watergate that following the money is the surest way to the truth, but now we may never know if following the betting would have paid off too.

By Andrew Gellatly

<http://www.iwar.org.uk/news-archive/tia/futuremap-program.htm>