

BY DAN HIBIG FOR THE WASHINGTON POST

If This Is Harebrained, Bet on the Hare

Last week, Capitol Hill erupted in outrage over news of a controversial Pentagon proposal to create a "futures market" in terrorism scenarios, in which investors would be able to bet on the likelihood of events in the Middle East, including terrorist attacks and assassinations. In the wake of the outcry, retired admiral John Poindexter, the man behind the plan, announced he will resign. But some people think the Defense Department shouldn't have caved so quickly. In fact, Defense Secretary Donald Rumsfeld might have offered a more spirited, um, defense of his agency's ideas.

To help him in his arguments, MIT Security Studies Program senior adviser Michael Schrage and Stanford University consulting professor of management science and engineering Sam Savage put together the following memo to President Bush. They offer it freely to the secretary and accept his gratitude in advance.

TO: POTUS

EX: Don Rumsfeld/OSD

RE: The So-Called "Terrorism Futures" Market: What Were We Thinking? Harebrained? Maybe. Irrational? Absolutely not. Provocative? Heck, yes! PAM—Poindexter's Policy Analysis Marketplace—was supposed to be provocative. Provocative is good. Getting people to think about the unthinkable is more important than ever. We can't afford complacency. That's been a consistent theme of your leadership.

Unconventional warfare requires unconventional thinking, Mr. President. That was true in Afghanistan and Iraq.

It's equally true for how we gather and assess intelligence. The hysterical criticism of our earliest efforts to craft an experimental marketplace to encourage fresh approaches to assessing threats should be seen as a badge of honor. The critics alternately quack like silly geese or cluck like Chicken Littles. Their outrage isn't much of a policy. Their contempt for markets speaks volumes.

We would be irresponsible to turn our backs on Nobel Prize-winning research in this area of economics and market psychology. The weapons community doesn't ignore breakthrough innovations; neither should the intelligence community. Our critics will damn us whatever we do. Let's be criticized for doing the right thing.

Our plan was never to make DOD the NASDAQ or NYSE of national security futures. That would be foolish. We could never be seen as honest brokers in a fundamentally American marketplace trading on threat-based speculations. Too many conflicts of interest; too many incentives to inappropriately intervene.

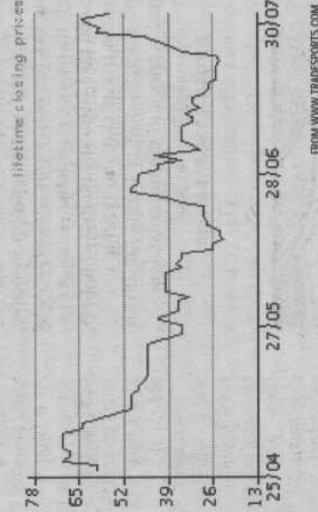
Our vision was to poke, prod and awaken a stubborn intelligence community to the predictive powers of free markets. Remember how we found out that in the days before 9/11, an unusual volume of bets were made against United and American airlines in the options market? Too bad our analysts weren't paying attention. But now we have opened their eyes to something that decision theorists have known for decades: The probability of events can be measured in terms of the bets people are willing to make. My economic advisers say predictive futures markets may ultimately prove more dependable, more cost-effective and more

You Bet

Futures markets are everywhere, and have been for a while. In 1995, the University of Iowa set up a scheme to let people buy futures with payoffs that depended on whether or not Colin Powell would accept the Republican presidential nomination. A Yes future would pay \$1 if he accepted; a No future would pay \$1 if he didn't. Once people had a bunch of futures in hand, they could trade them at whatever price they liked. Once Powell started his book tour, the Yeses rose while the Nos fell.

At www.Tradesports.com you can wager on anything from auto racing to the outcome of the Kobe Bryant trial. This chart shows the closing prices of the gamble that Saddam Hussein will be caught by Sept. 30. Note the spike after the deaths of his sons (on July 22).

A quick glance at www.NewsFutures.com late last week suggested that Ariel Sharon will outlast Yasser Arafat, Tony Blair has about an 80 percent chance of staying in office in 2004, and Jacques Chirac has about a 6 percent chance of winning the Nobel Peace Prize in 2003.



FROM WWW.TRADESSPORTS.COM

up a betting parlor so that people could go in ... and bet on the assassination of an American political figure?" Not only can I imagine it, Mr. President, I'd be grateful for it. Outraged senators who whine about our inability to anticipate threats while denying us new ways of gathering intelligence can hardly claim to be concerned about protecting the homeland. There will always be a bull market in congressional hypocrisy futures.

The idea that it's okay to pay \$30 million to folks who tell us where Uday and Qusay were hiding but morally repugnant to invest \$1 million to set up viable market mechanisms to help us track al Qaeda operatives is simply ludicrous. Our assessment of Iraqi WMD capabilities would have been transformed if we had forced George Tenet and the CIA to adopt an "intelligence futures" approach as part of the post-9/11 reassessment. We should have had an internal predictive futures market as part of our quality control. Shame on me for not pushing it harder.

The irony of this unfortunate brouhaha is that PAM was never unique. Poor Poindexter had to fall on his sword for a "controversial innovation" that already exists. Even we couldn't have dreamed up the gambles available at Tradesports.com, or any number of other electronic futures markets.

As a matter of national security, we need to influence the growth of these markets and to influence their rules and regulations. Precision-guided munitions and Stealth technology have cost-effectively changed the nature of war; we want market mechanisms to transform the nature of intelligence. The left-wing attacked Stealth and PGMs as a waste of money. Why should we be surprised that they attack market forces as well? Let's proceed.

Authors' e-mails:
schrage@media.mit.edu,
savage@stanford.edu

useful for net assessment than much of the intelligence product we get today for National Intelligence Estimates. As we both know, Mr. President, sudden spikes in oil futures usually reveal more about Middle East stability than any five sight intercepts from Fort Meade.

Poindexter's PAM was a tactical pawn that we've sacrificed in our ongoing effort to transform our troubled intelligence infrastructure. Its real purpose was to stim-

ulate the growth of predictive futures markets in Tehran, Islamabad, Shanghai and Paris, not just Las Vegas and Langley. Let's get a university in Dubai to launch just such an effort with al-Jazeera and have the National Security Agency monitor its traders. We don't just want to know what the people there think; we want to know what they're paying to predict. As Sen. Byron Dorgan complained, "Can you imagine if another country set