

# A bump in the road for prediction markets

By [Steven D. Levitt](#) August 9, 2006

My friends over at [Tradesports](#) are catching some heat. Tradesports is an online prediction market that allows you to make bets on all sorts of unusual outcomes.

A controversy is brewing, though, over the outcome of a contract on whether North Korea would have a missile launch before July 31. Reading the newspapers, you might think that North Korea did a test missile launch, but the folks at Tradesports, based on the specific wording of the contract, decided that the launch that took place did not qualify. You can [read about the controversy at Chris Maase's website](#) and in [SmartMoney magazine](#). The SmartMoney article has a nice discussion of why these prediction markets might ultimately prove to be more important than just a way for gamblers like me to have some fun.

According to the SmartMoney article the controversy boils down to the following:

*One of the contract's rules is that "the source used to confirm a test missile being launched and leaving North Korean airspace will be the U.S. Department of Defense."*

*The problem is that, according to Tradesports spokesman Matt Bonner, they made "numerous efforts to receive direct confirmation from the DoD" but were told "no statement involving the missile test and North Korean airspace would be forthcoming, as those specifics are considered a matter of national intelligence/security."*

*Bonner emphasized that “a confirmation source is, by definition and necessity, an integral part of the proposition on which contracts trade” – and said that traders are “obligated to be familiar with the rules of a contract before they place an order.”*

I have no strong opinion on the outcome — I think it is a tricky call. There are a couple of points that this controversy raises in my mind:

1) Tradesports has no direct stake in the outcome. Unlike a bookie, they don't take a position. They just create contracts and provide a place for people to trade against other people. This is important, because Tradesports has no incentive to make the wrong choice for their own profits. You want the person deciding whether a contract won or lost to be indifferent to the outcome, and Tradesports is. The contract terms may have turned out to be the “wrong” ones ex post in the sense that the contract didn't match public perception. But these markets are in their infancy and will improve with time.

2) There is nothing like creating a group of people with direct financial interests to create and stir controversy. I have been contacted by at least five different people who lost money on this Tradesports decision. I can't think of another issue not directly related to Freakonomics or one of our columns that has spontaneously led so many people to independently write me.

3) I am unable to find out exactly how many contracts were outstanding on July 6, the day that North Korea fired the missiles. I don't think the total dollars at risk were very large — maybe only \$10,000 or less. If I were Tradesports, I would go back to that data and just go ahead and payoff both side to generate goodwill, good publicity, and make future traders confident that in the case of future controversy their interests will be handled fairly.

As for me, I'll stick to betting on the really important current events, [like who will win American Idol](#).

