

We are professors and academic researchers from a variety of disciplines—from economics to political science to law. We are writing in support of legalizing the use of prediction markets for electoral outcomes, not just for Kalshi but for all other Designated Contract Markets (DCM) under the supervision of the Commodity Futures Trading Commission (CFTC). We believe these markets are squarely in the public interest, and reject claims that they constitute gambling or may threaten the integrity of our democratic process.

- Election prediction markets are a powerful resource for researchers. Researchers have been using the data generated by existing markets such as the Iowa Election Market (IEM) and PredictIt for over fifteen years (see, for example, “Party Influence in Congress and the Economy,” from Erik Snowberg, Justin Wolfers and Eric Zitzewitz). Much of this research falls into two camps: first, some researchers use prediction market probabilities to estimate the effect of the election on various economic variables. Second, other researchers use prediction market probabilities to learn what events actually influence campaigns. A legalized market with greater liquidity and participation numbers should allow these efforts to expand even further. As such, these contracts serve the public interest.
- The CFTC solicited public comment on the price-basing utility of election contracts. In our experience observing the market, financial market participants routinely use the probability of various parties’ controlling Congress (and the Presidency) to accurately price various assets. An accurate valuation of many investments, assets, physical commodities, and the value of services requires an accurate assessment of the future trajectory of the political environment. The political environment has significant and predictable impacts on business, and it is a significant factor that affects valuations. A fully-approved market without the limitations on existing unregulated markets will provide even better data that not only can be used for pricing financial assets, physical commodities, and services, but no doubt will.
- Furthermore, election contracts have bona fide hedging utility. Companies already hedge electoral risk demonstrating that this demand is real and large. However, these hedges are often indirect, since there are no election-based event contracts, and their pricing is not as accurate as an event contract on the elections would be.
- The CFTC requested a number of comments regarding the likelihood that the contract will be used by retail traders such as individuals, families, and small businesses for hedging (see questions 8-10). There may be many assumptions underlying this line of questioning, including a doubt as to whether elections actually impact individuals, families, and small businesses in a predictable way, and whether they are sophisticated enough to manage risk. The answer is yes. Hedging is a form of risk management. Individuals, families, and small businesses all are exposed to myriad events that will have

economic impact if they occur. Elections make many of these events more or less likely to occur. That change in likelihood is a direct change in the risk exposure that these individuals, families, and small businesses face. That change to risk is direct, predictable, and no less real because it is faced by a retail participant as opposed to a big bank. Additionally, the CFTC should continue to allow all participants, including retail participants, to make their own risk assessments, and determine how best and in what amounts risk should be managed.

- The CFTC also asked for comments on whether exchanges should have to prove an existing market demand for hedging before listing a new product. As made clear above, there is a demonstrated market for hedging this product, and to be clear, this product would pass the test implied by questions 7-10. However, the CFTC should refrain from adopting any of the tests implied in these questions as they are overbroad and will have a negative impact on innovation: the line of questioning is the kind that is indicative of the type of government overreach that generally stifles innovation. If the CFTC would force an exchange to prove that there is an existing demand for hedging, the CFTC risks preventing innovation, and significantly stunting the growth and development of event contract markets and other futures and derivative markets. Additionally, the CFTC should not substitute its judgment for market participants' own assessment of their risks and how best to manage their risk.
- Additionally, the CFTC asked about position limits. The proposed position limits are correlated conservatively to individuals and small businesses; it could be higher. However, that does not impact whether the product is likely to be used for hedging. Indeed, the lower position limits are important to responsible innovation. To the extent that there are speculative questions about the impact of election markets on election integrity, it makes sense to set position limits low initially, and gather data. If the data demonstrates that the concerns that the contracts will harm election integrity are unfounded, the position limits can be expanded. The CFTC should encourage these types of measures as they are indicative of responsible innovation.
- A common theme of the CFTC questions is in regard to whether election prediction markets constitute gaming. They do not. An election prediction market is no more gaming than traditional financial markets, including commodity, futures, and derivatives markets, due to the vast economic utility of the contracts. While it is true that a portion of market participants may speculate, this is fully consistent with normal market functioning. Many participants in energy or agricultural markets are speculators, yet their presence does not refute the economic utility of those contracts. If anything, these speculators serve an important role by providing liquidity and rapid price-discovery. Considering the vast hedging and price-basing value of these contracts, it would be a mistake to consider these “gaming”.

- In addition, these markets are resilient against manipulation. In academic studies of manipulation on existing prediction markets, price ‘pump’ attempts were short-lived and The combination of greater liquidity and number of participants makes such a phenomenon substantially less likely on a well-regulated market.¹² In addition, the relatively low position limit means any one participant, even maxing out their total position, is highly unlikely to be able to move the market in a meaningful way for any meaningful period of time as sophisticated traders enter on the other side of the market to profit off of the mispricing.
- Manipulation of the election itself seems even less likely. The argument would be that if someone now has a financial stake in the outcome of over 400 elections, they may either change their own vote or attempt to change the vote of others. This argument ignores the fact that people *already* have a *significant* amount at stake in elections. Additionally, these fears are unfounded speculation, and ignore the empirical fact that direct election trading exists in many other countries, such as the U.K., without such documented ill effects. Moreover, the contract has been designed to prevent that from happening by imposing Know-Your-Customer authorization, CFTC oversight, and a modest position limit. Changing the outcome of any election by even an infinitesimal amount, let alone altering a national election or the totality of all the Congressional elections, would be far more costly than the proposed position limits. This would be true even with position limits ten times larger. While it is worth considering a trading prohibition on people who have a unique insider status (e.g. members of Congress, their Chiefs of Staff, people working in state boards of election, etc.), this objection should not be grounds for rejection of this valuable social activity.
- If these markets have any impact on the electoral process at all, it would be a positive impact. Polling error has increased in recent years, polarization is at an all time high, fake news is rampant: a market-based mechanism for forecasting the outcome of the midterms would be a vastly superior alternative to polling and punditry, and would thus foster a healthier and more reasonable debate around the electoral process. Combating fake news and providing a better mechanism for truth makes the proposed contracts very much so in the public interest.

¹ For a historical analysis, see: Paul Rhode & Koleman Strumpf, 2006. "Manipulating political stock markets: A field experiment and a century of observational data," *Natural Field Experiments* 00325, The Field Experiments Website.

² For the theoretical argument, see: Robin Hanson, “A Manipulator Can Aid Prediction Market Accuracy”, 2007. <http://mason.gmu.edu/~rhanson/biashelp.pdf>

Ultimately, these are economically valuable markets (not gaming markets) that promote the public interest through superior forecasting. The Commission should embrace this valuable activity by bringing it under its regulatory umbrella.

Signed,

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