# COMMENTARY

Tom W. Bell[*]

## INTRODUCTION

The market mechanisms proposed in *Predicting Crime*[1] offer many virtues. The authors describe several of these—unbiased information collection; incentives that encourage disclosure; opinions weighted by conviction; information aggregation; instantaneous and continuous feedback—and convincingly argue that these structural features stand to help prediction markets outperform alternative institutions in forecasting the interplay of crime rates and crime polices.[2] In that, *Predicting Crime* adopts an economic point of view and speaks in terms of practical experience. After all, similar structural features have already appeared in other successful prediction markets, such as those offering trading in claims about the weather,[3] flu outbreaks,[4] or box office returns.[5] By contrast, this Comment adopts a legal point of view and speaks about as-yet theoretical disputes.

Part I briefly recaps the problematic legal status of prediction markets—especially real-money markets open to the general public—under state and federal law in the United States. Part II explains why, thanks to their substance rather than to their structure, the sort of market described in *Predicting Crime* would be an especially good candidate for judicial protection from regulatory interference. In contrast to most other prediction markets, prediction markets that forecast crime rates and the success or failure of changes to criminal policy evaluate one of the core functions of government: protecting citizens from criminal activity. The information that can be gleaned from these markets makes them a powerful means of praising or criticizing the performance of government officials. That unique aspect of prediction markets in crime rates and policies gives them

---

    1.      M. Todd Henderson, Justin Wolfers & Eric Zitzewitz, *Predicting Crime*, 52 ARIZ. L. REV. 15, 19–31 (2010).
    2.      *Id.* at 19–24.
    3.      *See* CME Group, Weather Products Homepage, http://www.cmegroup.com/trading/weather/index.html (last visited Jan. 31, 2010) (offering real-money trading on various weather-related futures and options).
    4.      *See* Iowa Electronic Health Markets, http://iehm.uiowa.edu/iehm/index.html (last visited Jan. 31, 2010) (offering limited real-money trading on various heath-related claims).
    5.      *See* Hollywood Stock Exchange, http://www.hsx.com/ (last visited Jan. 31, 2010) (offering play-money trading on various aspects of the entertainment industry).

comparatively strong claims to First Amendment protection from political interference. Part III of this Comment concludes, as does *Predicting Crime*, with a modest proposal: this one describes how Cass Sunstein, as the newly confirmed head of the Office of Information and Regulatory Affairs,[6] could encourage federal agencies to experiment with prediction markets in general and prediction markets in crime rates and policies in particular.

## I. THE PROBLEMATIC STATUS OF PREDICTION MARKETS UNDER U.S. LAW

The legality of prediction markets in the United States remains at best unsettled. Given the authors' background in economics, *Predicting Crime* understandably does not have a great deal to say about the legality of the prediction market it proposes. The authors sagely observe that "it is essential that a crime prediction market not violate relevant anti-gambling laws at both the state and federal levels," and hopefully suggest a couple of measures that might help to ensure that outcome.[7] Having given more than a little consideration to the legality of prediction markets under U.S. law,[8] I cannot offer so sanguine an assessment.

The problem is not that prediction markets are plainly illegal but rather that their legality remains subject to considerable uncertainty. Nor, contrary to the imputation of *Predicting Crime*, do anti-gambling laws pose the only threat to prediction markets; the authorities who regulate trading in commodity futures or securities might also claim that at least some forms of prediction markets fall within their jurisdiction. I have argued at length that the sorts of prediction markets discussed in *Predicting Crime* should not fall prey to anti-gambling laws and have described why, subject to some relatively modest structural amendments, such markets should also fall outside the regulations pertaining to commodities futures or securities.[9] Briefly, such markets do not offer gambling because skill can outweigh chance in determining who wins, do not offer futures trading because they offer the *present* delivery of potentially valuable claims, and do not deal in securities because those claims do not serve to raise capital. Still, I must admit that there remains a non-negligible risk that prosecutors, regulators, and judges might disagree.

At the very least, it bears noting that neither of the two legal prophylactics suggested in *Predicting Crime* offers a guarantee against the application of anti-gambling statutes. The article first suggests giving market participants sufficient initial endowments to ensure that they cannot, on net, lose money.[10] That strategy invites complications arising from the manner in which rights to such an

---

6.     *See* Office of Info. & Regulatory Affairs, *The Administrator*, http://www.whitehouse.gov/omb/inforeg_administrator/ (last visited Jan. 31, 2010).
7.     Henderson, Wolfers & Zitzewitz, *supra* note 1, at 58.
8.     *See* Tom W. Bell, *Private Prediction Markets and the Law*, 3 J. PREDICTION MARKETS 89 (2009) [hereinafter Bell, *Private Prediction Markets*]; Tom W. Bell, *Prediction Markets for Promoting the Progress of Science and the Useful Arts*, 14 GEO. MASON L. REV. 37 (2006); Tom W. Bell, *Gambling for the Good, Trading for the Future: The Legality of Markets in Science Claims*, 5 CHAP. L. REV. 159 (2002).
9.     *See* Bell, *Private Prediction Markets*, *supra* note 8, at 91–104.
10.    Henderson, Wolfers & Zitzewitz, *supra* note 1, at 58.

endowment vest, however. If the endowment vests immediately, participants could walk away with the gift without ever playing the market—hardly a result conducive to thick trading. Yet requiring participants to play the market before they could walk away with their endowments resurrects the specter of gambling, given that disgruntled participants might claim they had lost the time and effort they had "paid" into the market.[11] Next, the article suggests that, by combining pretend money with real prizes, a prediction market might avoid the taint of illegality.[12] That second strategy seems even less likely than the first to fend off anti-gambling statutes, given that market participants would still end up receiving valuable compensation for picking the right claims, even if only via a circuitous route.

Such lawyerly cautions do not establish that prediction markets in crime rates and crime policies would inevitably run afoul of anti-gambling statutes, of course. They merely show that *Predicting Crime* arguably underestimates the downside legal risks presented by such markets. Happily, however, it appears that in other respects *Predicting Crime* might have underestimated the legal case that proponents of the markets might make on their behalf. First, prediction markets about crime might win First Amendment protection from censorious state action. Second, federal regulatory policies might encourage the development of such markets as an aid to assessing the costs and benefits of agency actions. The next two Parts address each point in turn.

## II. FIRST AMENDMENT PROTECTIONS FOR PREDICTION MARKETS IN CRIME

*Predicting Crime* offers a promising solution to a vexing problem: how can we best assess the performance of those tasked to protect us from crime? We vest lawmakers, police, prosecutors, judges, and jailors with vast, and vastly dangerous, powers. In return, they promise (among other things) to keep us from suffering trespass, theft, battery, slavery, murder, and other such depredations. Thus do we—at least hypothetically—agree to move from a state of nature to the state.[13] But how can we know if that social contract offers us a net gain?

In these calculations, our firsthand experiences certainly count for a great deal. This makes sense in part because we all face a choice between abiding by the strictures of the reigning political order or opting for some other social institution. For almost everyone, almost all of the time, inertia decides the question. Emigration and immigration demonstrate, however, that people sometimes vote with their feet, against one state and for another. Revolution (though a much more

---

11.     *See* Bell, *Private Prediction Markets*, *supra* note 8, at 104 (detailing these problems and offering possible fixes for them).

12.     Henderson, Wolfers & Zitzewitz, *supra* note 1, at 58.

13.     So goes the central tenet of social contract theory, at least. *See, e.g.*, David Hume, *Of the Original Contract*, *in* ESSAYS MORAL, POLITICAL, AND LITERARY 465 (Eugene F. Miller ed., Liberty Fund Inc. 1987) (1777); John Locke, *The Second Treatise of Government*, *in* TWO TREATISES OF GOVERNMENT 365 (Peter Laslett ed., Cambridge Univ. Press 1967) (1690); THOMAS HOBBES, LEVIATHAN (1651) *reprinted in* III THE ENGLISH WORKS OF THOMAS HOBBES OF MALMESBURY (Sir William Molesworth, ed., Bohn 1839–1845).

rare phenomenon) demonstrates that people who are driven to desperation may go so far as to effect a change of governments via raised fists and loaded weapons.[14]

Voting with ballots, rather than with feet or arms, offers a cheaper way of choosing political organizations.[15] In theory, at least, democratic processes can help to ensure that a state protects the life, liberty, and property of its citizens. In practice, however, democracies too often botch the job (conceding, of course, that they generally do better than monarchies, tyrannies, and the like). How can democracies in general, and the constitutional republic of the United States in particular, give voters more and better information about the performance of those they elect? *Predicting Crime* offers a solution that is at once original, theoretically sound, and imminently practical: markets designed to predict how different political conditions will affect the amount of crime that residents of a particular jurisdiction will suffer.

Prediction markets in crime rates and policies not only provide information crucial to any democracy, they provide a new and powerful way for citizens to express their views about political processes. Suppose that you live on the south side of Chicago, in a neighborhood once leafy and rich but now barren and poor. The mayor and your local alderman have time and again promised you that things will get better—that your kids will walk on safe streets to secure schools, that the cops will clear the corners of drug dealers, that punks will go to jail for breaking into your car. But nothing gets better. Your kids grow up and move away, or go to prison, or get gunned down in gang wars, while the empty promises of politicians pile up like malt liquor bottles in a vacant lot. You complain, of course, but that does as little good as your one, little, occasional vote.

The sort of markets described in *Predicting Crime* would give you and your neighbors a more direct and influential way to tell the world—especially that little corner of it down at City Hall—whether Chicago is headed for better times or for hell in a handbasket. Especially when the forecast looks bad, public servants might not appreciate such frank and well-informed assessments of their performance. That would trigger an urge to censor—and provide the very reason that such markets should be protected as one of the freedoms of expression covered by the First Amendment.[16]

Skeptics will counter that the First Amendment covers only speech—not spending. The U.S. Supreme Court only recently weighed in on the question of whether or not the expenditure of money can win protection as an expression of political views and held that political spending is protected under the First Amendment.[17] To the extent that advocates of campaign finance regulations have

---

14.     *See, e.g.*, THE DECLARATION OF INDEPENDENCE (U.S. 1776).

15.     *See generally* ALBERT O. HIRSHMAN, EXIT, VOICE, AND LOYALTY: RESPONSES TO DECLINE IN FIRMS, ORGANIZATIONS, AND STATES (1970).

16.     U.S. CONST. amend. I (forbidding laws "abridging the freedom of speech, or of the press, or the right of the people peaceably to assemble, and to petition the Government for a redress of grievances").

17.     *See* Citizens United v. Fed. Election Comm'n, 129 S. Ct. 2893 (2009) (mem.) (holding that government may regulate political spending by corporations but may not ban it). For background on the case, a report on the oral argument, and assessment of the

denied First Amendment protection for expenditures in favor of particular candidates or ballot issues, they have done so under the guise of safeguarding the integrity of democratic processes. In contrast, prediction markets in crime trends do not have a similar, pernicious effect. Unlike candidate or issue endorsements, they do not directly urge a particular vote; rather, they indirectly reflect the substantive success (or failure) of a particular candidate or policy and allow the voter to assess the implications of that message. Therefore, to whatever degree expenditures on political campaigns merit First Amendment protection, it should be possible to extend even greater protections to expenditures made on the sorts of markets described in *Predicting Crime*.

## III. WHAT CAN CASS DO?

Cass Sunstein, who as a legal academic showed a keen appreciation for the benefits of prediction markets (as well as a frank recognition of their limitations),[18] recently won an appointment as Administrator of the Office of Information and Regulatory Affairs (OIRA) in the White House's Office of Management and Budget (OMB). In his former career, Sunstein argued that "in many domains, private and public institutions should consider the use of [prediction] markets to supplement deliberative processes."[19] He added, in a passage that his new post makes especially salient: "Government agencies, including those involved with national security . . . should experiment with internal prediction markets."[20] What, though, can Sunstein do as the Administrator of OIRA to make prediction markets a reality? This Part seeks an answer to that question by examining the federal statutes creating OIRA and the Executive Orders that direct its functions. A careful review of those sources indicates that OIRA's Administrator has broad powers to encourage the use of prediction markets by federal agencies.

Federal lawmakers created OIRA[21] and delegated to its Administrator broad authority to "oversee the use of information resources to improve the efficiency and effectiveness of governmental operations to serve agency missions, including burden reduction and service delivery to the public."[22] Specifically, lawmakers directed the Administrator to:

> (A) develop, coordinate and oversee the implementation of Federal information resources management policies, principles, standards, and guidelines; and
>
> (B) provide direction and oversee—

---

possible impact on First Amendment law, see Adam Liptak, *Day at Supreme Court Augurs a Victory on Political Speech, but How Broad?*, N.Y. TIMES, Sept. 10, 2009, at A28; Adam Liptak, *Justices, 5–4, Reject Corporate Spending Limit*, N.Y. TIMES, Jan. 22, 2010, at A1.

    18.    *See generally* CASS SUNSTEIN, INFOTOPIA: HOW MANY MINDS PRODUCE KNOWLEDGE (2006).

    19.    *Id.* at 198.

    20.    *Id*.

    21.    44 U.S.C. § 3503(a) (2009) (establishing OIRA as an office in the OMB).

    22.    *Id.* § 3504(a)(1) (describing authority and functions of the Director of the OMB); *see also id.* § 3503(b) (directing OMB's Director to delegate to OIRA's Administrator authority to administer all functions under 44 U.S.C. §§ 3501–21).

> (i) the review and approval of the collection of information and the reduction of the information collection burden;
>
> (ii) agency dissemination of and public access to information; [and]
>
> (iii) statistical activities . . . .[23]

Those provisions alone should suffice to establish the OIRA Administrator's authority to establish prediction markets designed to improve the collection and dissemination of statistical information about the federal government's operations. Yet, additional statutory language regarding the Administrator's authority makes the case for federal prediction markets even stronger. Lawmakers commanded that OIRA's Administrator, invoking powers delegated from OMB's Director, shall: "foster greater sharing, dissemination, and access to public information";[24] "reduce information collection burdens on the public";[25] "maximize the practical utility of and public benefit from information collected by or for the Federal Government";[26] "promote public access to public information";[27] and take a wide variety of measures to improve the efficiency, integrity, and utility of federal policies for collecting and disseminating statistical information.[28] Sunstein, of all people, should recognize prediction markets as an excellent—indeed, essential—means of fulfilling the legislated ends of his office.

In addition to broad statutory authority, OIRA's Administrator can cite the commands of the President as further justification for encouraging the development of federal prediction markets. The White House has, by Executive Order, directed federal agencies to assess the costs and benefits of all regulatory actions, favoring those that offer the greatest net gains,[29] and to base their decisions in such matters on the best "scientific, technical, economic, and other information" available.[30] How can federal agencies figure out which information qualifies as such? The same Executive Order designates OIRA as the repository of expertise in such matters,[31] giving OIRA's Administrator considerable leeway in getting federal agencies to use prediction markets to measure the costs and benefits of federal regulation.

Neither OIRA's Administrator, nor his immediate superior, the Director of the OMB, could directly force a federal agency to adopt prediction markets; their powers go only so far as reviewing an agency action to ensure that it conforms to executive orders and the President's regulatory policies.[32] Still, even

---

23.    *Id.* § 3504(a)(1).
24.    *Id.* § 3504(b)(2).
25.    *Id*. § 3504(c)(2).
26.    *Id.* § 3504(c)(4).
27.    *Id.* § 3504(d)(2).
28.    *Id.* § 3504(e).
29.    Exec. Order No. 12,866 § 1(a), 58 Fed. Reg. 51,735 (Sept. 30, 1993). The provision makes an exception for statutes that require something other than an analysis of net benefits. *Id.*
30.    *Id.* § 1(b)(7).
31.    *Id.* § 2(b).
32.    *Id*.

that limited power gives them considerable sway over federal rulemaking processes—so much so that some critics have complained that OIRA review gives the President "control over the substantive decision making of agencies."[33] At any rate, there can be no doubt that OIRA's new Administrator could at the very least start a public conversation about how prediction markets stand to improve the federal regulatory process. This is especially true given that the President has commanded him to "convene, from time to time, conferences with representatives of businesses, nongovernmental organizations, and the public to discuss regulatory issues of common concern."[34] Sunstein could thus do a great deal to turn his appreciation of prediction markets—whether they deal in claims about the enforcement of criminal laws or other topics of vital public interest—into a matter of federal policy.

Making prediction markets a part of the federal regulatory process would greatly help to alleviate doubts about their legal status. Most notably, given the Constitution's Supremacy Clause,[35] such markets would probably escape the reach of state anti-gambling laws (and, thus, the federal anti-gambling statutes premised on violations of state law). Specifically, state laws that might otherwise outlaw federal prediction markets would suffer implied preemption both because state law would stand "as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress,"[36] as evinced in the statute establishing the OIRA and its objectives, and because simultaneous compliance with state and federal law would not be possible.[37]

Prediction markets set up to help federal agencies assess regulatory options could thus even invite public, real-money participation without running afoul of any state laws. The status of such markets under federal laws pertaining to trading in commodities futures or securities would remain a different, and less easily resolved, question. Much would turn on the exact structure of the prediction markets run on behalf of federal agencies—a detail as yet impossible to discern. At the very least, however, it seems likely that a federal law enforcement agency would show far greater deference to a mechanism adopted by another federal agency in order to fulfill its mission (perhaps under pressure from OIRA) than it would to a similar mechanism adopted by a private party for private ends.

## CONCLUSION

This Comment on *Predicting Crime* has focused on three related legal observations. First, in general, the legal status of prediction markets remains

---

33. *Rulemaking Process and the Unitary Executive Theory: Hearing Before the Subcomm. on Commercial and Administrative Law of the H. Comm. on the Judiciary*, 110th Cong. (2008) (statement of Rick Melberth, Director of Regulatory Policy, OMB Watch), *available at* http://www.ombwatch.org/files/regs/PDFs/house_judiciary_testimony.REM.050608.pdf.

34. Exec. Order No. 12,866 § 4(e), 58 Fed. Reg. 51,735 (Sept. 30, 1993).

35. U.S. CONST. art. VI, cl. 2 (providing that "[t]his Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby . . .").

36. Hines v. Davidowitz, 312 U.S. 52, 67 (1941).

37. Fla. Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132, 142–43 (1963).

largely unsettled under state and federal law. Second, prediction markets in crime rates and policies, because they would facilitate the critical assessment of the performance of government officials, can make a uniquely powerful claim to deserving First Amendment protection from censorious state action. Third, the new Administrator of OIRA, Cass Sunstein, has both an appreciation of the utility of prediction markets and a mandate to encourage their implementation by federal agencies. In sum, therefore, we can thank the authors of *Predicting Crime* for describing a type of prediction market that might improve public policy both in theory and in practice.