

EconoFact Chats: Online Prediction Markets: Benefits, Costs, and Regulation

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I'm Michael Klein, executive editor of EconoFact, a non-partisan web-based publication of The Fletcher School at Tufts University. At EconoFact, we bring key facts and incisive analysis to the national debate on economic and social policies, publishing work from leading economists across the country. You can learn more about us and see our work at www.econofact.org

Michael Klein

You can bet that you'll like today's podcast. Well, not literally, but there are lots of things you can bet on. You can bet on who will win the World Series. Currently, the Dodgers are favored at 30%. You can also bet if there'll be a big earthquake in California before 2027. The chances of this from the prediction markets are 3%...and whether the House of Representatives gets a Democratic majority – 85%. Over the past few months, you could have bet on what countries will President Trump say during September, North Korea led at 38%. Which designer Taylor Swift chose for her wedding dress – Dior led at 66%. Prediction markets have become big business. Kalshi is valued at \$11 billion, and Polymarket at \$8 billion. While it may be a pleasant and relatively benign pastime to bet on Dior, there are also worrisome aspects of the growth of these markets. To discuss these issues, I'm pleased to welcome back to Econofact Chats Gary Gensler. Gary is Professor of the Practice of Global Economics and Management, as well as of finance at the MIT Sloan School of Management. He previously served as the chair of the Commodity Futures Trading Commission in the Obama administration, something that's very relevant for today's discussion. Gary also served as a chair of the Securities and Exchange Commission during the Biden administration, and Undersecretary of the Treasury for Domestic Finance during the Clinton administration. He and Simon Johnson, Gary's colleague at MIT, have the podcast Power and Consequences, with a recent episode on prediction markets that I would recommend to you. Gary, good to speak with you again today.

Gary Gensler

Oh, it's terrific to be with you, Michael, and to be with your listeners again.

Michael Klein

So, Gary, betting is probably as old as money, and there's a long history of sports betting. Even well before it was legal, bookies had a thriving business. What makes prediction markets today different from this long-standing activity?

Gary Gensler

Well, you're right that some form of betting, gambling, prediction markets, if you wish, have been around since antiquity. I think technology has shifted it quite a bit. We have had online betting. In fact, New York State had online...some form of betting on the horses and so forth. You had to go into a physical location, but in essence, you were doing it electronically once you were there. But I think what really shifted in the last several years is these new startups: Kalshi, Polymarket, crypto.com, and some others. They got

registered at the federal government with an agency called the Commodity Futures Trading Commission that I was honored to run a while back, and it's caught a lot of people's attention...it caught a great deal of attention...and starting just a few days after President Trump came into office, literally a few days before he was inaugurated, Kalshi announced that they would put sports bets on their platform, and they started a handful of days after he was inaugurated. I note that because it was also about that time that the President of the United States' son, through some venture firms that he's associated with, took economic interest in polymarket and became an advisor to Kalshi. But nonetheless, the sports betting...it is estimated is fully about three quarters of these platforms' revenue model...and may have been over 90% back in 2025. So it's got a lot of [inaudible]. It's where I think the casinos in the country are worried that they're going to lose competition and revenue. The large sports betting platforms called FanDuel and DraftKings are also concerned that they'll lose revenues, and it's playing out in courts across the United States. There's a big set of lawsuits between the federal government and the state governments, but I'm sure we'll get into that in some of your questions going forward...and even Native American tribes, because Congress back in 1988 passed a law and said that individual tribes in this country could have casinos across this great country of ours. So, there's a lot of litigation and politics about who oversees these organizations. Basically, who oversees gaming and gambling, and is it even allowed? Because 11 states in the United States do not allow gambling. In fact, the 39 states that do allow it, most of them only allow it once you're 21, and yet Kalshi and Polymarket let the entire country go on at the age of 18. So, you can imagine there's a lot to sort through. But back to you, Michael.

Michael Klein

Well, we are going to get to some of these things, but before we do, Gary, you talked about casinos. Well, the stock market is sometimes called a casino. Isn't that a type of event betting as well?

Gary Gensler

Well, look, you raise a really good point. There's uncertainty and predictability, or may I say, there is uncertainty about the predictability of the value of anything trading on the markets. It could be currency markets, it could be stock markets, it could be bond markets, crypto markets, and on and on. I think the distinction here is at least twofold...maybe more. One is there's not an underlying issuer. It's not like you have a company that's issued debt, and you're buying or selling that debt instrument or stocks, so to speak. The other thing is, there's some question about whether these contracts are even being used for hedging. We've had contracts that don't have an underlying issuer for, well, centuries. Ever since really the Japanese invented something called a futures contract back in the 1730s, so that farmers growing rice in Japan, and later farmers in the United States growing wheat and corn and so forth could hedge a risk about the price of their crop at harvest time. They didn't know if they'd have the crop. They didn't know if they'd have the corn or wheat. So, you're absolutely right, Michael. We've had some form of prediction markets, I'll say around agricultural commodities, going back centuries, and there were debates even in the 19th century about whether that was gambling or gaming.

Michael Klein

You raise an important thing, though, that the stock market is used to raise capital for firms, and the futures markets are a way that potentially vulnerable farmers or other people can hedge their bets or hedge

their risks against a bad crop or something like that. Do prediction markets about Taylor Swift's wedding gown or whether Donald Trump is going to say something in a certain amount of time...do they likewise serve any kind of social purpose other than perhaps entertainment?

Gary Gensler

Well, listen, entertainment is a social value. I think that if I could just narrow it down between two economists here, the question is, do they serve some form of purpose to hedge a risk. In essence, is there a commercial, economic, financial risk that you're hedging? That farmer is hedging a risk, the risk of the price of corn, wheat, barley. Energy companies are hedging risk every day. Here we have this challenge for the capital markets, and really a challenge for the whole global economy of the U.S. and Iran still at war. Well, what's the price of natural gas, what's the price of oil? You can understand that underlying risk. Who designs Taylor Swift's dress, or how many times President Trump is going to mention somebody in a day, or Elon Musk on his X account is going to mention something? I don't know, Michael. I think that's just entertainment value. It may give a lot of people a dopamine rush to try to guess what's going to happen and how many mentions there's going to be, but it doesn't feel that that's really about an economic or commercial risk.

Michael Klein

Well, one argument I know that's been made because I've heard you talk about this before, is that you could use you know what people call the wisdom of the crowds. So, DARPA, the Defense Advanced Research Project, after 9/11, wanted to do sort of a prediction market about certain events, but that was shut down within a day because of concerns. So, you can't bet on anything, right?

Gary Gensler

Well, it's a really good point, and I'm going to talk about another type of form of so-called betting. Think about insurance. Insurance is how you hedge your risk. But what if you were trying to just buy insurance on somebody you don't know? Maybe you're just buying insurance on the leader of a nation, and you're saying, "will they live or will they die? You're actually not allowed to do that. That's prohibited. You have to have what's called an insurable interest when you buy life insurance. It either has to be on yourself, your family, or maybe an employee or the like. By the way, this was banned in Great Britain in the 18th century. Parliament voted on it. They also prohibited insurance, or you could call it betting, if you wish, on ships because they found that pirates were basically buying insurance on ships and then potentially sinking those ships, and see King George II in the 1750s thought that wasn't good and Parliament passed that and banned that. That's called admiralty insurance. So yes, you can ban things absolutely, and that's what we did actually when I was at the Commodity Futures Trading Commission. It was not a big piece of the Dodd Frank reform effort, but after the financial crisis, Congress passed a law called Dodd Frank, and as part of that, they gave the Commodity Futures Trading Commission authority to look at contracts, technically event contracts on assassination, war, terrorism, gaming, and unlawful acts, and that they could prohibit them. This was a reaction to what you talked about from 2003 that DARPA initiative. There were a number of senators that said no, that should be banned. You shouldn't be able to buy and sell and speculate on somebody's assassination.

Michael Klein

So, I know you're a big movie fan, and the movie *Double Indemnity* comes to mind here. I'll recommend that to our readers...or to our listeners. But you know, all of these kinds of talk about this issue of what you might think of as insider trading...that somebody, for example, bets on in *Double Indemnity*, you know, through insurance, his wife's demise, and then tries to effectively do that. But there are also less ghoulish cases, like George Santos recently got banned because of insider trading. Polymarket bets on Israel attacking Iran, and the capture of Maduro...there are some issues with that. So, how do we prevent insider trading in these kinds of things? Is it just by preventing certain kinds of bets from occurring?

Gary Gensler

So, I think it's a challenge. When I got to the Commodity Futures Trade Commission, I asked about a movie called *Trading Places*, and your listeners might remember that Eddie Murphy didn't know much about trading, but he gets asked to start to learn about it. It's a quite humorous movie...and he starts trading on the futures markets in the days of physical trading. So, Eddie Murphy's character was trading on orange juice contracts, and found a crop report from the Department of Agriculture and said, "can I trade on that?" And he traded on and made money. What's this have to do with today? Well, when I got to this Obama administration, I asked, "might that be illegal?" And my staff said, "not yet. And we worked with Congress to have a small provision in that law to allow the government to basically say this is prohibited, and Congress passed that law. It's called the Eddie Murphy provision. So, if you trade on inside information from the government, Michael, not that you would do this..."

Michael Klein

No, no, I won't. No, no.

Gary Gensler

But that individual who is charged with trading on insider information...there was somebody in the U.S. military actually, who was charged with trading on whether Maduro, the head of Venezuela, would stay in office or not. And at least it's alleged...the case is not yet going to court, but it's alleged that he traded on insider information because he knew...he was in the military. He knew exactly what was going to happen, when it was going to happen, and traded on that. So it is against the law, but here's the hard thing: we have 90 years of experience in holding people to account, not to trade on inside information in the stock market. It still happens, but with the help of law enforcement, the Securities and Exchange Commission, the Justice Department, and state enforcement, it's kept to a small, I would say, sort of part of the market. I think it's a lot harder here, Michael. I don't know what you think, but I think it's a lot harder to really ensure that, for instance, political consultants don't know something about what's going on in their particular candidate or campaign in Ohio or Tennessee or in any state, and that they don't just trade on the market somewhere. I think it was really hard to keep sports athletes from throwing a game, or throwing just maybe an inning in a baseball game, if there's betting on the game, and I think that's why...I mean, it's a long-ago story, but the story about shoeless Joe Jackson and the Chicago White Sox, or what was called the Chicago Black Sox, who were charged with throwing the 1919 World Series, and they all lost their jobs. The commissioner of baseball kicked them out, even though a court out in Illinois acquitted them. But something changed a lot in the 2010s, and the large sports leagues, starting with the basketball league,

National Basketball Association...they wanted to actually allow sports betting..the NBA, Major League Baseball, on and on...wanted to allow sports betting. And then the Supreme Court weighed in in 2018, and said that a law that Congress had passed back in 1992 that basically prohibited sports betting in 46 of the states unless you were grandfathered...in 2018, the U.S. Supreme Court said that law was unconstitutional, so it was Katie bar the door, and sports betting took off. Well, as I said earlier, in 39 states...FanDuel and DraftKings became rather large, and then more recently, Kalshi and Polymarket have weighed in. And you see it expanding even further.

Michael Klein

So, I'd like to talk about a few things. So, we know that the commissioner of baseball banned shoeless Joe Jackson and others because he felt that it was ruining the integrity of the game...and then recently there was an issue in the NBA with the coach of the Trailblazers, I believe, rigging a game and a player in the Miami Heat. So, you know this speaks to the problem of the integrity of basketball or baseball. In what way could it be really damaging for the stock market to have insider trading? What would that do to financial markets, and why would that hurt the broader economy?

Gary Gensler

Well, I think that when any part of the financial system is rigged, if I can call it that, but that's really what that 1919 World Series debate was about. Was it rigged? Did somebody throw the game? And yes, did somebody then trade on the inside information that somebody was throwing the game? I think to take your broader point about the U.S. stock market, U.S. bond market, and so forth...if somebody has inside information, is trading on an individual company, or whether Nvidia is going to make their earnings forecast or not, then other people in the capital markets, feel that the game is a bit rigged. Will people still buy and sell stocks? Yes, but there'll be, I think, as economists would call it, a higher risk in the market, and thus a higher risk premium in the market. So, all fair-minded people who are playing by the rules of the game will actually get a little lower return, and then the insiders would capture excess returns. And I also think for the investing public, fewer people would want to be part of that market if they thought it was rigged. If somebody could trade, as they did in the 19th century...as they did all the way through the 1920s, and the collapse of the stock market in 1929, when the Senate stood up the famous Pecora Committee and looked at all that. They were called pools, where four or five or eight financial firms would get together and share information about how they were going to basically manipulate a stock.

Michael Klein

There's a really good recent book by Andrew Ross Sorkin about that called *1929*, and really goes into those details, and I think it really points out how that can be very damaging to finance, and how when something is damaging to finance, it feeds through and is damaging to the economy as a whole. I'd like to ask about another thing now. Gary, you've been very involved in some of the legal issues that have come up with respect to prediction markets, and there's a case now that's in front of different courts, and it could very well go to the Supreme Court. Could you briefly describe what that case is about, and the amicus brief that you wrote for that?

Gary Gensler

Well, thank you for raising that, and this will get resolved by the Supreme Court somewhere in the next couple of years, maybe even as early as the current Supreme Court term, which will end through next June or July. So, here's at the center of it all. We've had gaming and gambling, well, as we said, since antiquity, but it's been made legal in various states – 39 U.S. states, since 2018. And so, the question really is, is this still a part of state authority? Or when Congress was writing those financial reforms in 2010, did Congress actually preempt the states and move all of this to a small federal agency called the Commodity Futures Trading Commission? You might say as you're listening, how is that possible? How is that possible? Is sports betting a commodity? It doesn't sound like corn or wheat or rice or orange juice futures.

Michael Klein

Why would Kalshi be so interested in this question?

Gary Gensler

Well, it comes down to this – Kalshi set up something called a designated contract market about four years ago, and got registered at the Commodity Futures Trading Commission to trade what's called event contracts, and those event contracts that they first traded included event contracts such as what might happen to interest rates. The event contracts also would have included maybe about hurricanes and tornadoes and weather events, and this was contemplated somewhat when Congress passed that law called Dodd Frank...that some forms of event contracts that are associated with economic, financial, commercial consequences, that consistent with the concept of hedging that risk, that they might trade on the markets, and there were some small market makers in that area when I was running the CFTC as well. But Kalshi, a couple of MIT graduates, by the way, I think they might just still be in their late 20s by the way, Michael. They started it, and then they tested the waters a little bit and found themselves in court. They started to do event contracts on political elections, and this was just in 2024, and chair of the Commodity Futures Trading Commission, Russ Benham, and the commission said, "no, you can't do that. And a court in the U.S. and the District of Columbia said, well, actually, maybe you can do an event contract on the outcome of the election, whether the House or Senate would change parties. I think that that court was thinking, well, the role of an election, like will the House change parties, that might have some economic consequence. But as I mentioned, just a few months later then, Kalshi decided, well, let's list sports contracts. Let's list sports betting. In fact, Kalshi early on advertised you can now get sports betting in all 50 states. I might not have the exact words, but the words 'betting' and '50 states' were in there, and so it's an economic incentive to build a business, even if that incentive, Michael, might go right up against state law.

Michael Klein

So, this is like a federal versus state thing in some ways, right? 11 states don't want this. Kalshi is saying no. The federal government can overrule it, and whether or not the states want it...this is not your choice. What do you say in your amicus brief?

Gary Gensler

I just want to add one other thing. It's also about revenues. So, the 39 states that do oversee it...think about Nevada. Think about Nevada that's had casinos and some form of sports betting for decades, and were grandfathered in that 1992 congressional law called PASPA. What I say in the amicus brief is nothing could be further from what we were trying to do. The reforms in 2010 were all about a financial crisis that, in part, was because of an unregulated swaps market. Remember those terms, credit default swaps.

Michael Klein

I remember those.

Gary Gensler

Remember interest rate swaps...and that's what we were doing, and I was honored to be head of the Commodity Futures Trading Commission at the time. There is one prong in the definition of swaps that speaks to event contracts, again associated with commercial risk, associated with hedging, basically, Michael. Kalshi and the current administration are saying that preempted all these states, not just the 11 that prohibit sports betting, but the 39 that allow it, and the Native American tribes that have about 300 casinos in this country, so the tribal authorities as well. And what I say is basically that couldn't be further from the truth. And here's just a common-sense thing to think about: Harry Reid was the majority leader at the time, and for those that don't know the name or didn't work with Harry, he was a senator from Nevada, and he was the majority leader of the U.S. Senate. And he had been early in his career the Chair of the Nevada Gaming Commission. And think about Las Vegas and casinos and gaming and how important that is to the economy of Nevada, how important it is to the politics of Nevada. There is no way Harry Reid would have ever let that small agency I was running, the Commodity Futures Trading Commission, take the authority away from Nevada. Nor would he have ever allowed that there'd be a national platform like a stock exchange, you might say, but a national platform that might take some revenues away from the casinos in Nevada. So, they say all politics is local. Harry Reid would have never let that happen. He would have thrown me out of his office. That's kind of what I say in the amicus brief.

Michael Klein

Well, we're recording this at the end of September, and a lot of this will come to a head in October when this will be posted. And it'll be interesting to see how this plays out. So, one last thing I'd like to ask you about, Gary...we talked about, is there a social utility to prediction markets...event prediction markets? And one idea is, well, you get an idea of the wisdom of the crowd. But it could be that there's this feedback loop. So, suppose, for example, news came out about the President's dissatisfaction with a particular cabinet member. And then this raises the odds in an event prediction market that the person would get sacked, which in turn...these higher odds are viewed by the President as legitimizing his decision. So, in this feedback loop, the things keep, you know, working towards building on each other. It's not really the wisdom of the crowds at that point, is it?

Gary Gensler

Well, it's really good. And look, I mean, back to your earlier question, the stock market, the bond market, in a sense you would say, is the wisdom of the crowd. Though there's many reasons to think that markets don't fully work as efficient markets, and that, of course, many investors are chasing excess returns and want to be the next Warren Buffett, so to speak. That's the logic, the wisdom of that crowd. But on the other hand, what you're talking about reminds me of a story all the way back from the 16th century. There used to be an active market in Rome about betting on papal conclaves – who would be the next pope? Well, there came about Pope Gregory. I think it was Gregory XIV, if I'm not mistaken. And in the 1590s, he said that...so to speak, the wisdom of the crowd is influencing the conclaves itself. He had won the election. He had become the pope. But after that, he banned through a papal bull any more betting on papal conclaves, because he felt it would not only somehow hurt the integrity of the next conclave (of course, he would have no longer been pope), but it would hurt the integrity of those cardinals meeting. But it also might influence them. It might influence them like you're saying, that if you were betting on whether a particular cabinet member was going to be in or out, it could influence them.

And I'll say this about current elections. You could imagine that somebody would say, listen, I'll go on Polymarket and I'll spend a few hundred thousand dollars in an election to move the odds. This would be illegal, I think, but I'm just saying that they might be motivated to do it, to say I want to move the odds so that then the media will follow me. Because when the odds go up, then the media thinks I'm a serious candidate, and all of a sudden, you know, Cook Political Report, or the New York Times or RealClearPolitics say, well, the prediction markets say you've got a 52% chance of winning. All of a sudden, maybe donors are starting to contribute to your campaign. So, I don't know how you protect the integrity of the political markets if the PACs and the donor community and folks that have money sort of push around the prediction market. Again, it's not legal. I'm just saying it's hard to protect against that.

Michael Klein

Well, it's interesting that this is not just a current problem, but, as you said, goes back hundreds and hundreds of years. And so, I guess it's something we'll have to contend with, and the technologies making it more pervasive. So, Gary, thanks very much for speaking with me today. This is a really interesting issue that potentially has a real impact on not just the economy, but on people's lives in important ways as well.

Gary Gensler

It's terrific. It's been a lot of fun

Michael Klein

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