

COMMENT08-4
①**secretary**

From: Smith, Vernon [vsmith@chapman.edu]
Sent: Friday, May 02, 2008 8:06 PM
To: secretary
Cc: rhahn@communityprep.org
Subject: Response to CFTC Request on Event Contracts

**Received CFTC
Records Section**

5/7/08

OFC. OF THE SECRETARIAT

MAY -7 PM 2:41

RECEIVED
C.F.T.C.

Release: 5493-08
For Release: May 1, 2008

CFTC Requests Public Input on Possible Regulation of “Event Contracts”

What public purpose is served in the oversight of these markets and what differentiates these markets from pure gambling outside the CFTC’s jurisdiction?” said CFTC Acting chairman Walt Lukken.

Responder:

Vernon L. Smith,
George L. Argyros Chair in Finance & Economics
Professor of Economics & Law
Chapman University
One University Drive
Orange, CA 92866
2002 Nobel Laureate, Economics

Response:

1. On oversight: I suggest that initially this function be entirely limited to a monitoring and data archive function. Such information should be available for experimental, econometric, finance and other research scholars to study. If new regulatory rules governing rights to take action (“property rights”) are needed beyond those that emerge in the ordinary course of private institutional design for trading, let them evolve out of these research studies including examination by controlled testing in the laboratory. (Regulations controlling fraud, theft, deception, and so on already exist and would apply). It was from experimental economics (in Iowa) that event contract trading first blossomed, and many ongoing research questions arise in dealing with contract design, event measurement feasibility, etc. These are primarily empirical issues and the combination of field and

experimental data made possible by the CFTC initiatives are of great importance.

2. Event markets do not constitute gambling. Gambling involves the deliberate creation of artificial zero-sum opportunities to engage in risk taking decisions that redistribute existing resources. Event contract markets are in the class of variable-sum stock and derivatives' markets in which information on the future outcome of productive and technological activities is dispersed, uncertain, and rendered valuable to society when aggregated into prices. The information priced in these markets enables actions to be taken that create wealth. Similarly in event markets, better information made possible by trading event contracts produces social gains that make such activity wealth enhancing. Thus if a futures market in Florida orange juice enables improved predictions of frost, better crop decisions enhance wealth creation and potential improvements in technology. Moreover, all these issues are important generators of testable hypotheses, which can help to inform both the extent to which they create social and economic value and whether new regulations are desirable.
3. Bear in mind that any limitation on the emergence of new market forms must necessarily run the risk of also limiting new forms of specialization and wealth creation. We need always to be open to such new possibilities.