

GUEST COLUMN

Efficiency, not morality, behind terror betting parlor

By Denis Collins

With good reason, most Americans found the Pentagon's recent efforts to create a futures market predicting terrorist activities and political instability to be morally repugnant.

But now, hard-core free market apologists, who tend to have the ear of the current presidential administration, are taking the offense by arguing that Admiral John Poindexter was merely applying the virtue of free market analysis to the prediction of political instability.

Hal Varian, a professor of business, economics and information technology at the University of California at Berkeley, says Poindexter had a "good idea" that "got bad publicity."

Poindexter's brainstorm was that people who place bets, whether gambling or stock market addicts, want reliable information in order to minimize their economic risks. If all the starting players of the Green Bay Packers suddenly came down with the flu, head coach Mike Sherman would keep this information a secret from the opposition in order to maximize last-minute strategic surprises. As a result, bettors demand publication of medical reports and odds are adjusted accordingly.

How does this logic apply to the creation of a futures market for political instability? Predicting political instability in Israel is a no-brainer; those betting on a terrorist attack there will earn little money because everyone would have the same bet, reducing the winning payout.

But the Pentagon wants information on "long shots" and unanticipated but significant threats. For instance, the odds for a revolutionary overthrow of the Madison Common Council are quite slim. But if, all of a sudden, a lot of money was bet predicting that it'll happen tomorrow, then that's useful information for the Pentagon (and Common Council members) to have. Underpaid yet highly informed political science professors could earn substantial consulting fees predicting state and local instability!

What we have here is a typical business ethics dilemma — a clash of values between efficiency and common sense morality. All too often efficiency trumps common sense morality in the business and political arenas.

Efficiency is not always the most compelling reason for doing something, particularly when it conflicts with common sense notions of morality. For example, the most efficient way for me to get my two kids to school on time might be to drag them by the hair out of their beds and out the door without breakfast, giving me plenty of time to peacefully read the morning newspaper. But for good reason, such action would result in my arrest for child abuse, not to mention the emotional scars my kids would carry. Appropriately, the potential and actual harms caused to the weak outweigh the efficiency concerns of those who are more powerful.

So what harms would be generated by Poindexter's political instability futures market? Since no one is currently betting on a revolutionary overthrow of the Madison Common Council, why not throw a huge amount of money on the long shot and hire a thug for a few bucks to do the job?

Poindexter tried to weasel around this issue by placing a \$100 limit on winning payouts. But capping potential earnings is antithetical to free market theory. It would be irrational to invest money to generate knowledge about political instability if the winning payout is only \$100. Information thrives in the stock market because the smartest players can earn infinite payouts. So under Poindexter's amended rules, there eventually would have to be a market correction permitting substantively higher earnings.

If creating such an economic incentive regarding Madison's political system seems perverse, is it not equally perverse to create a similar economic incentive for already politically unstable environments? There are other, more morally defensible ways to achieve the intended objective.

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