DARTMOUTH

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SUBMITTED VIA CFTC PORTAL
Secretary of Commission
Office of the Secretariat
U.S. Commodity Futures Trading Commission
Three Lafayette Center
1155 21st St, NW
Washington, DC 20581

Re: Review of KalshiEx LLC's proposed Congressional Control Contracts pursuant to Commodity Futures Trading Commission Regulation 40.11(c)

Dear Chairman and Commissioners,

I am writing in support of Kalshi's application to run prediction markets on political outcomes. I will argue that prediction markets offer significant public benefits with minimal downsides.

I am a Professor of Economics at Dartmouth, and a significant component of my research agenda involves prediction markets. My work includes both studies of prediction markets themselves and research that uses prediction market prices as an input to an analysis. I attach a bibliography to the end of this letter.

I have found political prediction markets to be particularly useful in tracking the arrival of political news that influences other asset prices, allowing one to understand the economic effects of political outcomes. Examples include prospective analysis of the expected impact of the 2003 Iraq War (Wolfers and Zitzewitz, 2009) and the 2016 Presidential Election (Wolfers and Zitzewitz, 2016 and 2018), as well as retrospective analyses of other Presidential and Congressional elections (Snowberg, Wolfers, and Zitzewitz, 2007a and 2007b). Prediction markets on policy outcomes, such as the corporate tax rate, also informed my analysis of the post-event evolution of beliefs about the consequences of the 2016 election and Brexit vote (Fisman and Zitzewitz, 2019).

In the course of this research, I spoke with numerous financial market participants who find prediction market prices a useful input into their decision making. By aggregating information about political risk, political prediction markets allow investors to focus on other issues, potentially reducing asymmetric information and improving market liquidity. Research on emerging market corporate bond markets have found an analogous role for sovereign bonds (e.g., Dittmar and Yuan, 2008).

In order for markets to be useful, people have to trade in them. If traders are rational and only participate out of a profit motive, unsubsidized markets will unravel, as the less informed investors exit. Traders need to be willing to participate even when they should rationally expect to lose money. Three reasons why they might do so are entertainment, overconfidence, and hedging (Wolfers and Zitzewitz, 2006).

Markets need to reach a certain scale before they are useful for hedging, and this will likely never happen unless we tolerate markets that are fun and/or on topics about which investors find it easy to be overconfident. Two of the three firms who ran the corporate prediction markets I studied in Cowgill and Zitzewitz (2015) included fun markets. Participants told us that they often started trading for the fun markets, but stayed for the serious ones.

These forces are, or were, clearly also at work at Tradesports, Intrade, Betfair and Predictit. Markets on topics such as sports, or the number of times President Trump tweets, arguably do not provide information on a topic of broad direct economic relevance. Yet they are often the "killer app" that brings traders to the markets that do.

Political prediction markets, however, are the rare combination: they are economically useful, but also fun to trade in and on topics that inspire strong and sometimes overconfident opinion. So the case for allowing Kalshi to run them is two-fold: they will both provide useful information in themselves, as well as likely augment the liquidity of the many other useful markets Kalshi is running, on topics such as COVID, climate change, and air transportation congestion.

Finally, your Question 13 raises concerns about politically motivated manipulation of the prices in the markets. As Hanson and Oprea (2009) correctly argue, manipulation encourages entry to trade against it. In the long run, this improves liquidity and the accuracy of prices. Moreover, the long run often arrives sooner than one might expect, as past suspected episodes of manipulation have involved relatively quick reversion of prices (see e.g., Rhode and Strumpf, 2008), consistent with the lab experiments of Hanson, Oprea, and Porter (2006).

In summary, I strongly support Kalshi's proposal, and hope it, and other proposals like it, are approved.

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