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PETER LEWIS ON TECH

A Bad Bet on a Futures Market

Admiral John Poindexter won FORTUNE's 2002 Worst Technology of the Year award for his 'Total Information Awareness' program. His latest lightning-rod project, an exchange designed to take bets on future terror attacks, looks to have cost him his job.

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By Peter Lewis



Peter Lewis

Our old electronic privacy nemesis, Adm. John M. Poindexter, was in the news again this week, this time for his Pentagon-backed scheme to create an [online futures market](#) where players could profit by accurately predicting terrorist attacks, North Korean missile launches, political assassinations, and other acts of geopolitical mayhem.

News of the Pentagon program, which FORTUNE [first reported on](#) in its March 3rd issue, surfaced again this week and immediately drew criticism from leaders of both political parties. Democrats in Congress called it "grotesque," Republicans called it "absurd," and even Deputy Defense Secretary Paul D. Wolfowitz called it "too imaginative."

Wolfowitz also said he was shocked to learn of the program, which was being developed in the Defense Advanced Research Projects Agency, which he oversees. Shocked, indeed.

A quick aside:

Rick Blaine: How can you close me up? On what grounds?

Captain Louis Renault: I'm shocked ... shocked to find that gambling is going on in here.

[A croupier hands Renault a pile of money]

Croupier: Your winnings, sir.

Captain Louis Renault: Oh, thank you, very much. Everybody out at once!

And now, back to our narrative:

The nation's capital is a place where bad ideas often have long lifespans, yet within a day of the disclosure, public and Congressional outrage reached such a pitch that DARPA was compelled to kill the program and Admiral Poindexter was forced to resign.

Longtime readers will recall that Poindexter was the 2002 winner of the annual Worst Technology of the Year award for his Orwellian "Total Information Awareness" program, which will create a giant database that gathers and sifts intimate information about all citizens, under the guise of detecting aberrant behavior that might suggest potential terrorists. Your medical information, credit report, bank and credit card records, police records, travel history, telephone and online records, et cetera, would be gathered by the government and analyzed to determine whether you fit a profile of a potential troublemaker.

The Bush Administration is still backing this plan, although it has changed the name to "Terrorist Information Awareness" in a feeble attempt to make it more palatable to the law-abiding citizens whom it would track. Congress last month ordered the Pentagon not to use the TIA program against American citizens, but the Bush administration is determined to continue work on the project.

Poindexter's latest bright idea, the futures trading system that would use the Internet to traffic in money and blood, was one of many computer-based programs developed under the Total Information Awareness package. The trading system was to have begun taking registrants today, on a government website.

Although this implementation was morally repugnant, the basic idea behind the blood futures concept is quite interesting, from a business point of view.

"The central idea of capital and market economics is that people put their money where their mouth is," said Andrew Whinston, a professor of information systems, economics and computer science at the Graduate School of Business, University of Texas. Whinston is one of the world's leading authorities on electronic commerce.

"People ask you what you think, but if you don't have money riding on the issue, you don't tend to think about it deeply," Whinston said. By coupling money with people's beliefs, he

said, "you often get better forecasts than by just asking people or taking polls."

Whinston cited the [Iowa Electronic Markets](#), a real money futures market, where the value of the contracts traded depend on the outcomes of political elections. They stop the market a few hours before the election and use the outcome to make predictions, which on the whole have been more accurate than opinion polls. Other examples are the [Hollywood Stock Exchange](#), which tries to predict the success of various films and the market value of various movie stars.

"What they did," Whinston said, referring to DARPA's blood futures market, "was to pick up that idea and try to apply it to events of terrorism. But the devil is in the details. You have to define these markets very carefully, otherwise you get into what is called moral hazard, as people try to manipulate the market."

In essence, Whinston explained, the online market is a sophisticated tool that — in theory, if it is designed correctly — provides a more accurate prediction of future events than other sources of information.

If the Pentagon did not trust the validity of CIA reports, for example, it could attempt to get more accurate information from the open market by putting a financial incentive on predictions.

The devil was indeed in the details of Admiral Poindexter's blood futures system. Good riddance to it, and to him.

Those interested in learning more about online trading markets will find a rich source in "[Electronic Commerce and the Revolution in Financial Markets](#)" (Southwestern Press), by Whinston and his colleagues.

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