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The Wisdom of the Crowds: The Rise of Prediction Markets

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I. Executive Summary

Once seen as a niche phenomenon, prediction markets like Kalshi and Polymarket have embedded themselves in the mainstream over the last few years. Prediction market volumes grew to nearly \$64 billion in 2025 and are on pace to reach \$325 billion in 2026.¹ A prediction market is an exchange-traded market that allows people to bet on the outcomes of almost any type of event, including financial, economic, political, and social events. Prediction markets rely on the “wisdom of crowds” to aggregate expectations about future events that are often more reliable than even the most accurate expert forecasts and estimates.² As most prediction market event contracts are designed to trade between 0% and 100%, their prices can be interpreted as the probability of the event occurring. Advocates of prediction markets claim that prediction markets are the future of finance, arguing that these probabilities provide socially useful information unavailable elsewhere. On the other hand, critics point to risks of market manipulation, a lack of regulation, and ethical issues associated with gambling.

As these markets continue to grow, they have drawn increased attention from policymakers, researchers, and financial institutions. In January 2026, Goldman Sachs CEO David Solomon claimed his firm is exploring prediction market opportunities.³ In February 2026, a Federal Reserve report found significant advantages in prediction markets over traditional forecasting tools for macroeconomic variables.⁴ While prediction market platforms like Polymarket and Kalshi currently face regulators in court, both Democratic and Republican senators have challenged the Commodity Futures Trading Commission’s (CFTC’s) authority to regulate event contract markets.⁵ The emerging relevance of prediction markets guarantees that debates surrounding their role in the future of finance and society will continue for years to come. This paper provides an objective overview of prediction markets, including their historical development, mechanisms, performance, applications, regulatory context, and risks.

¹<https://www.falconx.io/newsroom/from-opinions-to-odds-emerging-trends-in-the-prediction-market-landscape>

²<https://iemweb.biz.uiowa.edu/about-iem/research/prediction-market-accuracy-in-the-long-run/>

³<https://www.cnbc.com/2026/01/15/goldman-sachs-ceo-looks-at-how-to-get-involved-in-prediction-markets.html>

⁴<https://www.federalreserve.gov/econres/feds/kalshi-and-the-rise-of-macro-markets.htm>

⁵<https://www.semafor.com/article/02/18/2026/prediction-markets-won-over-trump-but-the-rest-of-washington-will-be-harder>

II. History

While prediction markets may seem new, the idea of using markets to aggregate information about future events has a long history around the world. Market prices have been used to forecast events since the early sixteenth century, when people would bet on who would succeed the pope.⁶ Friedrich Hayek is often credited with the economic theory behind prediction markets; in his seminal work, he wrote that “[t]he economic problem of society, to put it briefly, is a problem of the utilization of knowledge which is not given to anyone in its totality.” Rhode and Strumpf have found that in the 1800s and 1900s, Wall Street bet astonishingly large amounts on well-organized election markets, and these markets were highly accurate in forecasting.⁷

The first modern electronic prediction market was introduced in 1988 as an educational experiment. Created by the University of Iowa, the Iowa Electronic Markets (IEM) is an online futures market designed for educational and research purposes.⁸ In 2002, Goldman Sachs and Deutsche Bank created the first markets directly tied to macroeconomic outcomes. They were called “economic derivatives” but only ran for a few years before shutting down. Notably, however, Gurkaynak and Wolfers found that these market-based forecasts were “remarkably well calibrated” and “a modest improvement” over alternative survey forecasts.⁹ Various other prediction markets, such as InTrade, the Cantor Exchange, and PredictIt, emerged in the following years, mostly with limited success due to severe regulatory restrictions and low volume.¹⁰

Founded in 2017 and launched in 2021, Kalshi became the first fully regulated American financial exchange for event contracts by receiving approval as a Designated Contract Market (DCM) regulated by the CFTC. In 2020, Polymarket launched as a decentralized prediction market platform built on the blockchain. Together, these two platforms have achieved rapid expansion and dominated the prediction market sector over the last few years, gaining cultural traction especially among younger demographics.

⁶<https://www.brookings.edu/articles/prediction-markets-for-economic-forecasting/>

⁷https://users.wfu.edu/strumpks/papers/JEP_2004.pdf

⁸<https://iem.uiowa.edu/iem/>

⁹<http://www.econ.yale.edu/~shiller/behmacro/2005-11/gurkaynak-wolfers.pdf>

¹⁰<https://www.cftc.gov/PressRoom/PressReleases/6423-12>

III. Market Structure

Prediction market event contracts are tied directly to the outcomes of future events. Each contract trades at a price between 0 and 100 cents. After the event outcome is verified, the contract settles at 100 cents if correct and 0 cents if incorrect. At any point in time, the price reflects the probability that an event will occur. If the market for Candidate A winning an election trades at 75 cents, the market-implied probability of Candidate A winning is 75%. In these markets, the profit of traders is directly tied to the accuracy of their forecasts. This individual profit motive is the key difference from professional forecasters, who can often experience institutional pressures, conflicts of interest, or other incentives. Academic theory suggests this profit-based motivation in prediction market participants produces more accurate forecasts than professional forecasters.¹¹ Because prices update continuously in real-time, prediction markets offer valuable real-time probabilities that traditional weekly or monthly forecasts cannot match in frequency.

When trading on a prediction market, there is no “house” that sets the odds and serves as the counterparty to all positions. Unlike traditional gambling, participants trade directly against one another. Market-makers are firms or individuals that continuously post buy (bid) and sell (ask) prices, actively providing liquidity on these markets to ensure traders can trade instantly without waiting for a counterparty. Market-makers make a profit from the difference (spread) between the bid and ask prices, not necessarily from predicting the outcomes.

The two primary incentives for traders to enter prediction markets are speculation and hedging. Speculators attempt to make a profit by using superior information or judgment to take advantage of a market mispricing. Hedgers attempt to offset exposure against adverse outcomes elsewhere, such as a business hedging against an unfavorable regulatory decision. Most volume on prediction markets today is currently driven by speculation, as a lack of liquidity in many markets limits meaningful hedging activity. Attracting the institutional participation required to build deep hedging markets is one of the main challenges prediction markets face to move beyond a predominantly retail base. While the open access and anonymity of prediction markets are useful for bringing in participants with specialized knowledge that improves

¹¹<https://www.nber.org/papers/w1208>

forecasts, this also creates a risk for insider trading¹² and market manipulation¹³ with limited enforcement mechanisms.

The two dominant platforms today take structurally distinct approaches to market design. Kalshi is a federally regulated derivatives exchange due to its DCM registration with the CFTC. Contracts are settled in U.S. dollars and subject to CFTC oversight, similar to traditional exchanges like the Chicago Mercantile Exchange (CME). While being CFTC-regulated provides some legal clarity and credibility, it also limits the types of contracts Kalshi can offer and constrains the platform. Polymarket takes a different approach by utilizing the blockchain.¹⁴ Polymarket is a decentralized blockchain platform; there is no central intermediary, and contracts are settled on-chain through smart contracts. An advantage is that this allows for global accessibility and transparency on-chain.

IV. Performance and Forecast Accuracy

Prediction markets have shown forecasting advantages over traditional methods, though performance varies depending on the context of the market. Evidence from the Iowa Electronic Markets demonstrated that in elections, prediction markets “yielded very accurate predictions and also outperformed large-scale polling organizations.”¹⁵ The market was closer to the eventual outcome 74 percent of the time.¹⁶ More recently, a Federal Reserve working paper studied accuracy in forecasting macroeconomic variables. The paper found that Kalshi markets outperformed both the Bloomberg consensus forecast for predicting inflation and the Fed funds futures forecast for predicting the Fed funds rate.¹⁷ The performance of prediction markets tends to improve with specific market conditions. Prediction markets are most accurate with high participation, short-to-medium time horizons, and clearly defined resolutions. Thus, the forecast accuracy of major elections or FOMC rate decisions tends to be much higher than in more niche markets with less liquidity.

¹²<https://www.justice.gov/opa/pr/us-soldier-charged-using-classified-information-profit-prediction-market-bets>

¹³<https://www.npr.org/2026/04/23/nx-s1-5797876/polymarket-paris-weather-bet>

¹⁴<https://finpolicy.georgetown.edu/wp-content/uploads/2025/05/Decrypting-Crypto.pdf>

¹⁵<https://pubs.aeaweb.org/doi/pdfplus/10.1257/0895330041371321>

¹⁶<https://www.sciencedirect.com/science/article/pii/S0169207008000320>

¹⁷<https://www.federalreserve.gov/econres/feds/files/2026010pap.pdf>

V. Economic Applications

Proponents of prediction markets cite a wide variety of applications and use cases for businesses and policy-makers. The applications of prediction markets stem from the value of having dispersed private information transformed into a single price signal.

In the public sector, prediction markets can provide valuable information to policy-makers. Forecasts of macroeconomic variables such as inflation, interest rates, and recessions are widely used by various government agencies. The Federal Reserve has made note of the value of continuously updating price signals, compared to traditional forecasts made on a weekly, monthly, or yearly basis. In addition to monetary and fiscal policy, prediction markets can provide useful probabilities for public health preparedness, national security, infrastructure planning, or disaster response. For example, prediction markets can be used to estimate vaccine approval timelines, the likelihood of military conflicts, or whether a major infrastructure project runs over budget.

In the private sector, various academic studies have shown a wide variety of corporate applications of prediction markets. On the firm level, prediction markets can be used to aggregate employee knowledge for business decision-making. By incorporating information dispersed throughout the firm, internal prediction markets have been used to forecast demand and sales, manage budgets, test the success of product launches, or even decide where to open a new office. Some notable corporations have used internal prediction markets, such as Hewlett-Packard, Intel, Nokia, Ford, and Google. These markets improved on expert forecasts by up to 25%.¹⁸ On a larger scale, firms can use prediction markets to hedge against risks such as unfavorable regulatory or political decisions.

On Wall Street, brokers to institutional investors have pushed to open prediction markets to major financial firms.¹⁹ Prediction markets have advocated their platforms as ideal financial hedges for portfolios and as a source of alternative data for various portfolio risk events. In January 2026, Goldman Sachs CEO David Solomon said the investment bank was exploring a role in prediction markets, while in March 2026, JPMorgan CEO Jamie Dimon said the firm was considering offering prediction market services tied to financial and economic contracts.²⁰ With

¹⁸<https://www.jstor.org/stable/43869468>

¹⁹<https://www.bloomberg.com/news/articles/2026-03-11/prime-brokers-race-to-give-wall-street-access-to-event-bets>

²⁰<https://finance.yahoo.com/markets/options/articles/jamie-dimon-says-jpmorgan-chase-093000860.html>

prediction markets, banks can offer clients direct access to contracts on specific financial or economic outcomes. As liquidity deepens, institutional capital in prediction markets will likely continue to expand.

VI. Regulatory Framework

The regulation of prediction markets depends on the operational structure of the market and the jurisdiction. Some countries have classified prediction markets as betting platforms, subjecting them to additional regulation or outright bans. In the United States, Kalshi operates a CFTC-regulated exchange, while Polymarket's primary exchange is offshore and claims to block U.S. users. Through the acquisition of QCEX, a smaller CFTC-licensed derivatives exchange, Polymarket has obtained a DCM license and has begun approving some U.S. users to trade on its platform. The benefit for these platforms of operating under CFTC oversight is greater trust and transparency in their markets, encouraging more users.

Established by the Commodity Exchange Act (CEA) of 1936, the CFTC is the federal regulator of U.S. derivative markets, which historically include futures, options, and swaps. The CFTC first officially recognized event contracts in 1992 when it approved the Iowa Electronic Markets. The CEA allows registered exchanges to "self-certify" new derivative products, but prohibits contracts contrary to the public interest, including contracts that may involve assassination, war, or gaming. Election markets were prohibited until 2024, when Kalshi filed suit against the CFTC and won. In January 2025, the CFTC began to change its stance towards prediction markets under new leadership. Immediately after, prediction markets began listing sports markets in January 2025, which make up the significant majority of these markets' volume today.

These recent changes, and the rapid growth of prediction markets, have intensified debate over regulatory structure and authority. In 2018, the Supreme Court gave states the right to legalize and regulate sports gambling. Sports contracts make up an estimated 90 percent of prediction market volume, yet are not subject to sports gambling taxes and currently circumvent state restrictions. This has led to friction between states and the CFTC, with more than 20 federal lawsuits already filed by states and gaming authorities against prediction markets. The CFTC has aggressively asserted its exclusive jurisdiction over prediction markets. In February 2026, Chairman Michael Selig said, "The CFTC has the expertise and responsibility to defend

its exclusive jurisdiction over commodity derivatives, and that's exactly what we'll do."²¹ In Congress, bills to limit insider trading or ban sports and election contracts have gained bipartisan support. If the current administration fails to pass a new regulatory structure, or the courts do not provide a clear judgment, it is possible that future CFTC leadership could regulate event contracts entirely differently from the current approach, including a ban altogether.

VII. Risks and Limitations

Despite their advantages in forecasting, prediction markets face substantial risks and limitations around market integrity. Multiple instances of large and well-timed bets on specific event contracts have been widely publicized. While insider trading is well-defined in equity markets, prediction markets lack comparable regulation or surveillance. Some advocates for prediction markets claim insider trading is a benefit of these markets, as it increases the value of the information. However, excessive insider trading drives away liquidity, making the markets less useful. As a result, Kalshi and Polymarket have made attempts to regulate insider trading internally, adopting rules that are more prohibitive than the CFTC's. These platforms use internal enforcement programs to screen traders, run real-time market monitoring and surveillance, and have even fined traders.²² Market manipulation remains another concern. Many event contracts rely on strictly defined definitions to be resolved; however, these outcomes can often be easily influenced. Examples include contracts that settle based on whether a news outlet publishes a story or if a public figure says a certain phrase. This creates incentives for bad actors to manipulate the outcomes of these events.

Prediction markets also raise broader concerns around ethics. Many critics argue that markets on sensitive events, such as geopolitical conflicts, can create negative incentives or promote human suffering. Furthermore, because the majority of volume traded on these markets is on sports, there is no clearly defined distinction between "trading" and "gambling." Many critics argue that these platforms are contributing to the proliferation of gambling in the United States, especially among the younger demographic. Prediction markets allow individuals 18 to 21 years old to "trade," while gambling is typically limited to individuals over 21.

²¹<https://www.cftc.gov/PressRoom/PressReleases/9183-26>

²²<https://www.cftc.gov/PressRoom/PressReleases/9185-26>

VIII. Conclusion

The rapid evolution of prediction markets has contributed to growing interest from major financial institutions and policymakers. The ability to aggregate the wisdom of dispersed information into continuously updating probability signals has shown strong forecasting advantages over traditional forecasting methods. At the same time, prediction markets face significant challenges. Market integrity concerns around insider trading and manipulation could undermine the value that makes these markets so useful in the first place. The regulatory environment remains unclear as states challenge the authority of the federal government to regulate prediction markets. In order for prediction markets to fulfill their potential as a useful financial and policy tool, these challenges must be addressed with a clear regulatory framework in place. Without this, these markets risk wavering before they reach the scale required to fulfill their promise to be a future fixture in finance.

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