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Betting on Better Governance

by George Agbesi & Joshua D. Ammons

Nothing distinguishes more clearly conditions in a free country from those in a country under arbitrary government than the observance in the former of the great principles known as the Rule of Law. — F. A. Hayek

At one point, Gordon Tullock thought taxi medallions were inefficient but intractable institutions, a classic example of what he called the *transitional gains trap*. The medallion system persisted not because it served the public, but because the rents it generated were capitalized into medallion prices, making any reform politically impossible. Then came Uber, and within a matter of years this supposedly permanent institution crumbled. What if a similar technology shock could do the same for societies lacking the rule of law?

The rule of law, as Hayek understood it, means a government bound by rules fixed and announced beforehand, rules general enough to apply equally

to all, stable enough to permit planning, and transparent enough to constrain arbitrary power. Where these conditions hold, good things follow: longer lives, healthier children, better schools, cleaner air. Where they do not, as Douglass North and his colleagues have documented, ruling coalitions maintain power precisely through the discretionary distribution of rents. The countries that most need the rule of law are the least likely to develop it through conventional political reform.

Enter prediction markets, and specifically, the Web3 prediction markets now operating on public blockchains. These platforms allow anyone, anywhere, to trade contracts whose payoffs depend on future events. When a contract pays one dollar if an event occurs and nothing otherwise, its market price functions as a probability estimate. A price of sixty-five cents means the crowd believes there is a 65% chance the event will happen.

What makes these markets interesting for questions of governance is not merely that they aggregate information (though they do that remarkably well) but that they do so through mechanisms that reproduce, in miniature, the essential features of rule-of-law systems. Every transaction is recorded

on a distributed, immutable ledger. Market rules are encoded in self-executing programs that automatically manage trading, hold funds in escrow, and execute payouts based on outcomes. No intermediary decides who wins; the code does. No bureaucrat can alter the rules mid-course; they are fixed at the market's creation.

Generality, Equality, Predictability

Consider what Hayek meant by the generality of law. Legal rules must apply across cases without regard to identity or status; their legitimacy derives from this very impersonality. Prediction markets mirror this structure precisely. Each market is governed by a publicly posted contract specifying the event, the criteria for resolution, and the payout rules. These terms apply identically to every participant, whether a small bettor or a large liquidity provider. On platforms like Polymarket, a market forecasting an election sets the same terms for all traders. No actor can demand exceptions or individualized treatment.

Equality before the law similarly requires that rules bind all individuals equally, that no participant can secure privileged treatment. In traditional legal systems, administrative discretion or political

influence routinely undermines this ideal. But prediction markets embed equal treatment directly into their technical architecture. Once an oracle publishes the outcome, smart contracts settle the market automatically. All holders of a winning position receive identical payouts. No user can negotiate delays, seek preferential interpretation, or alter the settlement logic. This technical impartiality produces equality-before-the-law that does not rely on institutional integrity; it is enforced mechanically through code.

A functioning rule-of-law system also provides predictability, allowing individuals to anticipate the consequences of their actions. Prediction markets reproduce this by making their rules explicit, stable, and resistant to discretionary change. Participants know in advance what constitutes the event, which oracle will resolve it, what evidence will be considered valid, and how payouts will be executed. These parameters are fixed before trading begins and cannot be altered mid-course. This explains why prediction markets frequently outperform traditional polling: when incentives and rules remain stable, participants reveal their beliefs more accurately.

Constraining Power

Perhaps most importantly, the rule of law limits arbitrary government power by constraining officials through general and impersonal rules. Decentralized prediction markets extend this principle by distributing authority across network participants rather than concentrating it in any single institution. Because Web3 markets operate on public blockchains, governments cannot unilaterally censor outcomes, alter results, or seize control of the resolution mechanism without confronting decentralized resistance.

This friction is not a bug but a feature. Regulators may restrict on-ramps or pursue platform operators, but they cannot discretely intervene in the execution of smart contracts or the resolution of on-chain markets. The transparency of prediction markets also constrains narrative control. During the 2024 U.S. election cycle, Polymarket's publicly visible probability forecasts signaled shifts in expectations earlier than mainstream polling, reducing the ability of political actors to shape perceptions unilaterally. This dynamic was even more starkly illustrated during the capture of Nicolas Maduro in January 2026. Hours before the commencement of

'Operation Absolute Resolve', an anonymous Polymarket trader (account 'Burdensome-Mix') wagered roughly $32,000 on Maduro's removal, at a time when the market priced the outcome at a mere 8% probability. The trade resulted in a $436,000 windfall as the news broke. While this triggered immediate legislative backlash in the U.S. via the *Public Integrity in Financial Prediction Markets Act,* it underscores our core argument: prediction markets function as decentralized whistleblowers. By 'leaking' truth through price signals before official narratives are set, these markets break the state's monopoly on information, providing a transparent signal that even top-secret operations cannot fully suppress.

The Evidence So Far

Classical prediction markets like the Iowa Electronic Markets provide early empirical support for these claims. Studies show that IEM forecasts of presidential elections consistently produced lower errors than major polling aggregates, particularly in the final weeks before Election Day. The accuracy of these markets depended critically on rule stability: contract definitions, payout structures, and event-resolution criteria were fixed in advance,

allowing participants to coordinate expectations under predictable conditions.

Recent decentralized markets reproduce these dynamics at scale. During the 2024 election, Polymarket's prices exhibited statistically significant lead times relative to mainstream polling averages. Because resolution rules and oracle sources were announced in advance, traders could interpret price shifts with clarity rather than uncertainty. Public signals derived from stable rules help coordinate beliefs more efficiently than discretionary interpretation, the Hayekian mechanism at work.

On platforms like Omen and Augur, all participants interact with the same smart-contract architecture, which enforces participation rules, fee structures, dispute resolution, and settlement logic without distinguishing between users. The key governance feature of smart contracts is their inability to vary execution based on identity or status. Once deployed, their logic applies uniformly to all inputs. Consider a market forecasting whether the Federal Reserve will raise interest rates. The resolution text specifies the source, the precise condition triggering a payout, and the settlement timestamp. When the

oracle publishes the result, the contract executes automatically, delivering uniform payouts to all winners. The absence of discretionary interpretation operationalizes equality-before-the-law more rigidly than most administrative settings.

Competition, Not Replacement

We want to be clear about what we are not arguing. We are not suggesting that prediction markets should replace courts, legislatures, or constitutions tomorrow. Rule by code has obvious limitations: smart contracts cannot exercise the moral judgment of a jury, or provide the kind of flexible interpretation that complex human disputes often require. A world governed *entirely* by algorithmic certainty would be a diminished world.

But this is not an argument against prediction markets. It is an argument against monopoly. The relevant question is not whether code-based governance is perfect, but whether it can provide a useful competitive alternative in contexts where traditional legal institutions are failing.

Consider the situation facing citizens in countries where courts are corrupt, slow, or captured by political elites. Where a judge can be bribed to rule

against you. Where contract enforcement depends on knowing the right people. Where the official inflation statistics bear no relation to reality, and the state media publishes whatever the ruling party dictates. In such environments, the theoretical limitations of algorithmic governance seem rather less pressing than the practical failures of human governance.

For these citizens, Web3 prediction markets offer something valuable: an alternative institutional infrastructure that provides transparency without requiring honest officials, equal treatment without requiring impartial judges, and predictability without requiring stable political coalitions. A Venezuelan farmer cannot trust the government's crop price forecasts, but he might trust a prediction market where traders with real money at stake reveal their genuine expectations. A Ghanaian entrepreneur cannot rely on courts to enforce her contracts, but she might use smart contracts that execute automatically upon verified conditions. These are not perfect solutions. But they are *options,* and in institutional environments characterized by failure, options matter enormously.

The deeper point is that institutional competition can generate benefits beyond the direct services provided by competing institutions. When citizens have exit options, when they can route around failing courts by using smart contracts, or route around captured media by consulting prediction markets, the pressure on traditional institutions to improve increases. The threat of losing relevance concentrates the mind.

We see this dynamic in other domains. Mobile money services like M-Pesa did not replace formal banking systems in Kenya; they competed with them, served populations the banks had ignored, and ultimately pressured banks to improve their own offerings. Charter schools have not replaced public education, but their presence has, in some contexts, spurred traditional schools toward reform. The logic of interjurisdictional competition, long emphasized by scholars of federalism, applies to institutional forms as well as geographic units.

Prediction markets operating on blockchains represent a new form of this competition. They provide rule-of-law services, transparency, equal treatment, and predictable enforcement through technological rather than political means. Where

traditional institutions function well, such markets may remain niche tools for information aggregation. But where traditional institutions fail, they offer something more: a parallel infrastructure for coordinating expectations, enforcing agreements, and constraining arbitrary power.

The spillover effects could be substantial. When citizens can compare the performance of code-based contract enforcement against court-based enforcement, the failures of the latter become harder to ignore. When prediction market prices reveal information that state media suppresses, the costs of information control become more visible. When blockchain-based systems demonstrate that equal treatment is technically feasible, arguments that corruption is inevitable lose their force. Competition does not merely provide alternatives; it changes the terms of debate.

Conclusion

Prediction markets will not, by themselves, transform weak-institution countries into rule-of-law societies. The obstacles are real: limited internet access, low crypto literacy, the challenge of constructing reliable oracles in low-information environments, and the ever-present risk that

governments will simply block access to these platforms. Technology is not destiny.

But technology can change the calculus. Uber did not solve all the problems of urban transportation, but it broke a trap that seemed unbreakable. Perhaps Web3 prediction markets will do something similar for the rule of law, not by replacing courts and constitutions, but by providing competitive pressure that makes reform more likely and stagnation more costly. In a world where billions live under arbitrary government, that possibility is worth taking seriously.

George Agbesi is a student and Research Assistant at the Stephenson Institute for Classical Liberalism, Wabash College. Joshua D. Ammons is Scholar-in-Residence at the Stephenson Institute for Classical Liberalism, Wabash College. Send Joshua mail at ammonsj@wabash.edu.