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Clinton's Historic Surprise

Political prediction markets, polls and pundits may never have got it so wrong

By **JUSTIN WOLFERS**
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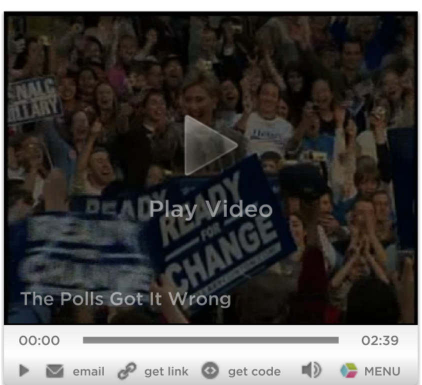
Judging by the pre-vote polls and prediction markets, the Democratic primary in New Hampshire created one of the most surprising upsets in U.S. political history.

Illinois Sen. Barack Obama was favored in the final pre-election poll of all 12 pollsters who surveyed voters since his surprise victory in Iowa, and was the unanimous favorite among television pundits. The only real question to be resolved appeared to be the size of Mr. Obama's majority.

His loss to New York Sen. Hillary Clinton was equally embarrassing for prediction markets, such as the WSJ Political Market[1]. Election-eve trading had suggested that Sen. Obama had a 92% chance to win in New Hampshire[2], while Sen. Clinton rated only a 7% chance[3].



New Hampshire voters delivered a surprising win to Hillary Clinton and easy victory for John McCain making this campaign once again a wide open race. Kelsey Hubbard reports on how the candidates are moving forward as the race moves on.

Against this background, it is no exaggeration to term the result truly historic. Not that there haven't been more dramatic upsets or come-from-behind wins that carried more significance -- this was just an early primary, albeit a pivotal one. But in terms of unpredictability, or at least the failure of everyone to predict it, it may have no modern match.

In a continuing research project with Andrew Leigh of the Australian National University and Eric Zitzewitz of Dartmouth, we are comparing electoral outcomes and prediction-market prices across all recorded markets in U.S. history, as well as other democracies, and examining just how often long-shot candidates actually win.

We were led to this research by an age-old racetrack puzzle economists call the "favorite-long shot bias[4]": Horse bettors historically have overbet long shots, and they win less often than their odds suggest. Our research suggests that similar biases hold in political prediction markets.

As such, Sen. Clinton's comeback is even more stunning, as political underdogs have historically won even less often than suggested by their prediction market odds.

Historical comparisons are already being drawn between the New Hampshire primary and the famous 1948 presidential race in which President Harry S. Truman beat Republican challenger Thomas Dewey, despite the infamous "Dewey Defeats Truman" headline in the Chicago Tribune.

Yet the magnitude of the Clinton surprise is arguably even greater. Indeed, historical research[5] by Professors Paul Rhode of the University of Arizona and Koleman Strumpf of Kansas University has shown that in the Truman-Dewey race, prediction markets had seen hope for President Truman despite his dreadful polling numbers, and he was rated an 11% chance of winning the election by election-eve. Thus, Sen. Clinton's victory on Tuesday was more surprising than President Truman's in 1948.

Indeed, the Clinton surprise was so great that she has largely recovered from her loss in the Iowa caucuses, and the prediction markets now rate her about a 6-in-10 chance to win the Democratic nomination[6]. (Her candidacy was rated a 2-in-3 chance on the eve of Iowa, and fell as to low as 1-in-4 on Tuesday.)

On the Republican side, there were fewer big movements in prediction markets. On election eve, Arizona Sen. John McCain was a 4-in-5 chance to win in New Hampshire, so his victory in New Hampshire wasn't surprising. He remains a 35% chance of winning the Republican nomination.

Former New York Mayor Rudolph Giuliani's poor showing also appears to have been expected, and he remains the clear second pick at 28%. Former Massachusetts Gov. Mitt Romney's second place finish, while a strong result, appears to have been largely discounted given his established New England credentials, and he has slipped slightly to an 11% chance of winning the nomination. So, too, former Arkansas Gov. Mike Huckabee's chances fell slightly to 16%.

While Sen. Clinton's unexpected victory has yielded red faces among the punditocracy, this also provides a useful opportunity for emphasizing just what a prediction market forecast says. That the price of a contract paying $1 if Sen. Clinton won in New Hampshire was selling for seven cents doesn't suggest that she was a sure loser. Rather, these prices suggest a probabilistic statement that the ultimate outcome was about a 7% chance. And as any horseplayer can tell you, sometimes the long shots do win.

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