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Political Markets Foresee Turning Point

Pundits and Prediction Markets Agree, New Hampshire Is Do-Or-Die

By JUSTIN WOLFERS

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On the eve of the New Hampshire primary, pundits are already asking whether Tuesday's vote will ring the death knell for certain candidates. Trading in prediction markets, both real-money betting sites and "play" money markets such as the [WSJ Political Marketplace](#)¹ says that it could be.

New Hampshire yields fewer than one percent of the national delegates to the nominating convention. And as Hillary Clinton's travelling press secretary Jay Carson noted of last week's caucuses, "Iowa is so small, it's like a mayor's race in a medium-sized city."

But the polls, prediction markets and pundits all agree this time around that early votes – even in small and unrepresentatively white and rural states – are important for determining the final nominee.

Last week Barack Obama was a clear underdog in the race for the Democratic nomination, and his victory in Iowa propelled him from a one-in-three chance of winning, to one-in-two. Even this rapid movement underestimated his post-Iowa momentum, and his strong showing in subsequent polls has led his chances to be further revised upward to two-in-three.

While Mrs. Clinton's standing has fallen sharply since Iowa, the real loser was John Edwards, whose second-place showing still led his chances of securing the nomination to fall from 6% to 2%. Against this background, Edwards' announcement on Sunday that he was going to stay in the race until the convention seems all the more unusual.

A potential explanation lies in the fact that Mr. Edwards' chances of becoming vice president have risen this week (albeit on small volume). Certainly his campaign is likely ruing his earlier comments that candidate forums be reserved only for serious contenders.

Academic researchers have long been interested in understanding the sources of these momentum effects. One possibility is simply that voters like voting for winners, and so quickly jump on an electoral bandwagon. But recent research by Professor Brian Knight and Nathan Schiff of Brown University suggests that there may be more to it than that.

Looking back to the 2004 primary race, [Messrs. Knight and Schiff write in their study](#)² that John Kerry's strong performance in Iowa led voters to revise not only their voting intentions, but also their assessments about his likeability, trustworthiness, strength and ability to inspire. The authors suggest that in these small states the voters actually get to know the candidates much more intimately than the rest of us, and

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so we give their opinions greater weight.

WISDOM OF CROWDS

To learn more about uses of political prediction markets, see:

- "[Best Bet for Predicting the Next President: Markets](#)³," recently in the *Journal*, by Justin Wolfers.
- "[Pricing Political Risks with Prediction Markets](#),⁴" by Justin Wolfers.
- A more in-depth treatment, including discussion of how prediction markets have been used by corporations, policymakers, and in finance, is available in the paper "[Prediction Markets](#),⁵" by Justin Wolfers and Eric Zitzewitz.
- A broader analysis of information aggregation is available in James Surowiecki's bestseller, "[The Wisdom of Crowds](#)⁶."
- A comprehensive analysis of the prediction markets run by the University of Iowa is available in "[Results from a Dozen Years of Election Futures Markets Research](#)⁷," by Joyce Berg, Robert Forsythe, Forrest Nelson and Thomas Rietz.
- An intriguing survey of political prediction markets over the past century is available in the research study "[Historical Presidential Betting Markets](#)⁸," by Paul Rhode and Koleman Strumpf.

Even so, it is hard for Mr. Obama to gain further momentum, as he is widely expected to win easily in New Hampshire, and is better than a nine-in-ten chance of winning this primary. Mrs. Clinton has retained a small lead in national polls, and at this stage, competing forecasts appear to be driven by the extent to which her lead will persist in the face of these early disappointments. Her campaign remains competitive in all of the larger states.

The absence of key candidates John McCain and Rudy Giuliani from the Iowa race made it much less informative about the Republican nomination race. Indeed, Mr. Huckabee's victory there only raised his stocks a little. More importantly, Mr. Romney only won silver, causing his chances of winning the nomination to drop even further, from one-in-four to one-in-eight.

The real beneficiary of Mr. Romney's stumble in Iowa has been Mr. McCain, whose stocks have risen sharply; he is currently a five-in-six chance of winning the New Hampshire primary and is the new market favorite to win the nomination.

The same academic research that suggests early primaries are important also suggests that voters expect a particularly strong performance in a candidate's own backyard, further raising the stakes for Mr. Romney, who was previously the governor of neighboring Massachusetts.

Just as the changing complexion of the Democratic race dominated this week's news, expect the next week to be dominated by news as the rest of the country makes inferences about the character of the leading Republicans.

Mr. Giuliani remains the exception, as his campaign has bet heavily against momentum effects, and he has stayed clear of retail politics in the small states. Mr. Giuliani's response to his weak showing in Iowa ("none of this worries me," adding somewhat bizarrely that "Sept 11, there were times I was worried") gives some perspective on his view about the importance of these early results. Whether voters remain as unperturbed will be revealed in coming days.

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