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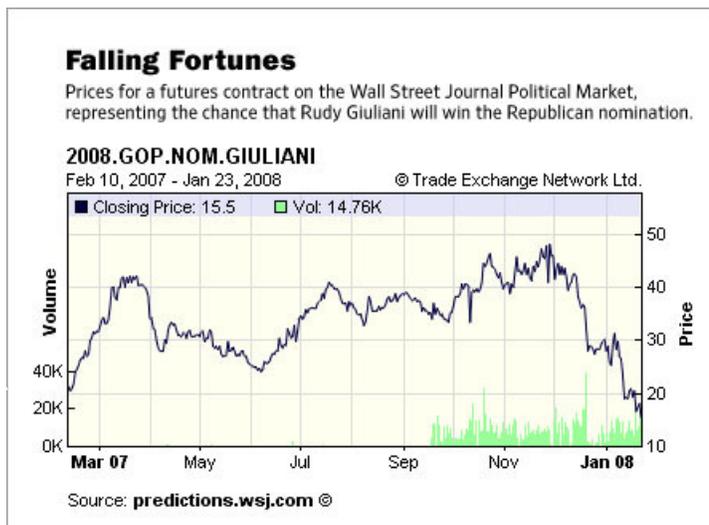
POLITICAL EXCHANGEBy **JUSTIN WOLFERS****How Rudy's Bet Went Wrong**

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Wither Rudy?

Rudy Giuliani took a big bet with his campaign strategy, opting to skip the early primary states in order to invest heavily in large, delegate-rich states like Florida, New Jersey and California.

For those who bought into Mr. Giuliani's alternative investment strategy, the returns have been disappointing. Indeed, futures contracts tied to Mr. Giuliani's chances of winning the Republican nomination have traded sharply down in political prediction markets since balloting began in Iowa on Jan. 3.



According to these markets, [Giuliani's chances of securing the Republican nomination](#)¹ have slipped from 27% on the eve of the Iowa caucuses – and above 45% back in November – to 16% today, making him the biggest loser among the mainstream candidates. What explains the decline of Mr. Giuliani's chances? Was this a flawed strategy, or has he been out-campaigned?

The conventional wisdom is that Mr. Giuliani adopted an approach that was highly risky at best. Yet the biggest risk of his strategy hasn't come to pass – no clear frontrunner has emerged from the early rounds of voting, and so is not facing the forces of momentum. If anything, his strategists should have been thrilled by the early primary outcomes.

To some extent, Mr. Giuliani's recent drop in the polls was expected, as some of his opponents enjoyed a bounce from their primary wins in the early contests. But is this the whole

story?

Prediction market prices can help resolve this debate. First, think back to the eve of the Iowa caucuses. Just as the Giuliani campaign understood that opting out of the early races would lead to a polling bump for his opponents, so too, those trading in political prediction markets surely understood that January would be a quiet month for Mr. Giuliani.



Because prediction markets are forward-looking, the robust Giuliani price on the eve of the Iowa caucuses already took account of the expected decline in voter interest in Mr. Giuliani through January. That the prediction market price subsequently fell so sharply tells us that something unexpected happened in the past few weeks, and that this news revealed him to be a less viable candidate than had been anticipated.

The most likely explanation is that Mr. Giuliani has dramatically underperformed expectations in the early races. While his campaign's "spin" is that he opted out of these contests, his name remained on the ballot. And the number of voters expressing a preference for Giuliani has been pretty dismal—he secured the nod from 3.5% of voters in Iowa; 8.5% in New Hampshire; 2.8% in Michigan; 4.3% in Nevada and 2.1% in South Carolina. In each of these five cases, Mr. Giuliani underperformed election-eve polls.

Of course, these numbers should not be taken entirely at face value. Delegates to the Republican convention aren't elected in proportion to the number of votes obtained, and so strategic voters in these states sometimes direct their preferences to the major candidates, rather than risk a "wasted" vote.

Even so, voters understand the demonstration effect that early balloting has on the rest of the nation, and so a vote for Rudy was never going to be completely wasted. Indeed, similar trade-offs have not prevented enthusiastic supporters of Ron Paul from voicing

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enough support that he has beaten Mr. Giuliani in every race except New Hampshire (where they were separated by only 0.8 percentage point).

An alternative explanation for the decline in Mr. Giuliani's stock is that his strategists had hoped that the early races would knock out most of the other candidates, and they liked his chances in a smaller field. But Mr. Giuliani's chances actually increased in the wake of the Iowa caucuses, even as this signaled the addition of one more candidate—Mike Huckabee—to the roster of plausible contenders.

All told, prediction market data tend to confirm that Mr. Giuliani's recent decline is due to a poor campaign, rather than a poor strategy.

Indeed, even as he has invested heavily in the larger states, prediction markets suggest that his chances of winning California, New Jersey, Florida and Pennsylvania declined precipitously in the wake of recent primaries. The main beneficiaries of Mr. Giuliani's collapse have been John McCain and Mitt Romney, who are now [the leading two candidates in Florida](#)² and [California](#)³, while Mr. Giuliani is now less than a one-in-six chance in each of these states.

Unfortunately for Mr. Giuliani, a candidate who is unpopular in both the early-voting small states and later-voting big states, just can't win.

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