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POLITICAL EXCHANGE

Edwards Dropout Offers Boost to Obama

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If Tuesday is primary day, Wednesday must be dropout day.

Rudy Giuliani's distant third-place finish in the Florida primary and his subsequent departure from the race has dominated political discussion. But it wasn't news. Political prediction markets had already priced Rudy as a long shot in Florida, and even before the primary viewed him a seven-in-10 chance to depart the race this week.

Instead, today's real news is the departure of John Edwards from the Democratic nomination race. His constant refrain that he would stay in the campaign was widely believed, and [he was rated a 96% chance to stay in the race through January¹](#), and a [60% likelihood of staying in through February²](#). So he was expected to stick it out at least through Super Tuesday, and possibly all the way to the convention.

It had long been clear that Mr. Edwards was no longer running for the nomination, as his loss in the New Hampshire primary [brought his chances at the nomination down to 2%³](#), and then last week, below 1%. But the Edwards candidacy was still important as he drew around one-in-six voters in national polls. Those voters are now looking for a new candidate.

For those who wish that Mr. Edwards was still in the race, we can turn to political prediction markets to find out which candidate is the nearest alternative. Here's an analogy to help explain the logic: If Pepsi withdrew from the Cola Wars, then sales of Coke would go up; 7-Up isn't quite as similar of a product, and so would benefit a bit less.

So too in politics. When word of Mr. Edwards's pending withdrawal leaked, [Mr. Obama's stock rose⁴](#). So the markets tell us that Mr. Obama is a better replacement for an Edwards candidacy than, say, Hillary Clinton, whose stock fell on this news. Despite the Edwards bump, Mr. Obama remains the underdog, and is currently a 38% chance of winning the nomination.

Polls have been testing Edwards voters for some time, probing them about their "second choice" for the Democratic nomination. Polls in New Hampshire suggested Edwards voters preferred Mr. Obama to Mrs. Clinton, whereas in South Carolina, the polls suggested the reverse. The market estimates, instead, tell us who Mr. Edwards's supporters are likely to favor in those states yet to vote.

The reason that prediction markets can be so precise in parsing out the specific consequences of the various changes over recent days is that they are traded literally minute-by-minute. In turn, this allows us to focus on the specific price movements that occurred when news of Edwards's announcement leaked.

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Unfortunately, the inevitability of Mr. Giuliani's withdrawal from the Republican race became clear as the polling numbers from Florida were reported. Thus, we cannot disentangle the extent to which Mr. McCain's subsequent surge reflected his strong showing in Florida, or the expected endorsement that will come from Mr. Giuliani.

The combined effect of these recent changes is that the Republican field -- like the Democratic field -- is now a real two-horse race, with [Mr. McCain garnering an 82% chance of winning the nomination](#)⁵ vs. [Mr. Romney's 15% chance of winning](#)⁶. The chances of a brokered Republican convention have also declined dramatically, falling from one-in-four to one-in-20.

It turns out that Mr. Giuliani wasn't the only New York mayor whose ambitions have suffered a major blow. As it has become increasingly clear that the two main parties will nominate electable candidates, the likelihood of Michael Bloomberg announcing a run for president has fallen from nearly one-in-five, to about one-in-15.

After the rich theater of the early primaries, the lead-up to Super Tuesday now looks pretty conventional, with each race expected to involve two candidates, and no third-party surprises.

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