Executive Q&A

Justin Wolfers, assistant professor of political economy at the Stanford Graduate School of Business in Palo Alto, Calif., tells NGS Contributing Editor David Ross about the article he and Harvard University's Andrew Leigh recently published: "Politicians Should Look to the Polls but Pray for the Odds."

Q Is it accurate to say that your recent research says that oddsmakers are more likely to be able to predict an election than pollsters or economic models?

A Yes, absolutely. The rationale comes from financial market theory, and particularly the efficient markets hypothesis, which says that markets are the most efficient way to predict outcomes. The final betting price will not only take into account the polls but economic models. The point is that betting markets are very efficient at predicting a whole range of outcomes from football and baseball to elections, as well as next year's GDP.

Q You had some experience in oddsmaking when you were younger, didn't you?

A Yes. I worked for several bookmakers in my native Australia. And kept at it, putting myself through college. Most of the gambling was on horses. Betting on elections is a relatively recent thing in Australia. I remain a keen bettor today—baseball, mostly, and I like to follow the election betting markets as well. I admit I'm quite intrigued by the online betting exchanges, like Betfair.

Q How do oddsmakers determine odds for an election?

A By taking account of much of the data that a political scientist would: the polls, the strength of the economy, and then post an initial price. The initial price is cautious, and the bookie responds to betting action. What can be particularly interesting is that most of the tickets can be written for one candidate while most of the money is bet on the other. Interpreting something like that can be challenging.

Q Does your research have practical applications for how we conduct elections, or conversely, on how odds are calculated for elections?

A The first thing it says is that betting odds are an extremely accurate predictor of election results. The implication for politicians is that if they are just worried about predicting whether they can win, rather than spending money for pollsters, they should look to the bookies in Las Vegas.

I first pointed this out in Australia in an op-ed piece in Sept. 29, 2001, called "Winner Take All." Politicians started to contact Centrebet, Australia's largest bookmaker. Some bet on themselves to try to generate interest. There were several races where the betting market suggested that the candidate was in trouble a long time before either the campaigns or the press appeared to notice.

Q Have your classes reflected your interest in gambling?

A At Stanford I teach a class in the economics of sports betting, combining insights from modern finance, psychology and economics, asking what the three fields can tell us about sports betting.

Q Why are the odds makers more often right closer to an election?

A It's simple information theory. Closer to an election you know more information than you know farther out. You know more polls, the closing line reflects that and allows the odds maker to reflect on the information, which might include insiders from the campaigns betting on the election. You watch where the money flows. The closing line in almost any situation is almost always a more accurate line.

Q Do oddsmakers have a predictive ability about other sectors of the society besides elections?

A Not oddsmakers per se but the aggregate betting market. The closing line about any event reflects what the oddsmaker thinks and the aggregate opinions of bettors.

You can think of an analogy between the betting market and the marketplace of ideas: The final price, so to speak, reflects some part of everyone's ideas and information, possibly in proportion to their accuracy. A financial market's final price is very efficient of opinion. So far we see that the closing line of NFL and baseball are good predictors.

Markets where almost no one is betting are not particularly efficient. The magic of the market comes about when all factors are included.

Q Are you following this year's national elections in the U.S. to see if your research jibes with the results?

A I have been. There's not been a lot of betting on this election. Most betting is on presidential elections. The University of Iowa runs an election stock market (www.biz.uiowa.edu/iem). At the moment you can buy an option that pays off $100 if your pick wins. For instance, an option that pays off if the Republicans take both houses currently costs around $40. *[Editor's note: See Iowa section.]*

Q Is it possible that if voters became generally aware of this phenomenon, they might change their behavior and alter the results?

A Absolutely. Voters like to vote for the winning candidate. The standard view is that a few days before the election, people want to be on the winning side, and so the favorite becomes more favored.

The other view is, if you are expected to win by a lot, you try to appear to be the underdog. Otherwise people will stay home because they'll figure their vote doesn't matter.

In the U.S., if someone is a runaway favorite, either in the polls or in a betting market, that could come back and bite you. Theoretically it could go either way. Most candidates would like to be a slight favorite to win. NGS