FOR A WINNER, FOLLOW THE MONEY

LONG BEFORE AUSTRALIANS knew the date of the federal election, they were betting on its outcome. Centrebet, one of the country's biggest book-makers, had taken $300,000 in wagers by Aug. 27; another $30,000 came in last weekend. Expat Justin Wolfers, a professor of business at the University of Pennsylvania's Wharton School, has a special interest in where the money is going. That's not just because he's backed Labor—currently at around $2.30, which he says reflects a 38% probability of victory. Wolfers believes that by the end of the campaign betting prices will reveal, more accurately than opinion polls, which party is going to win.

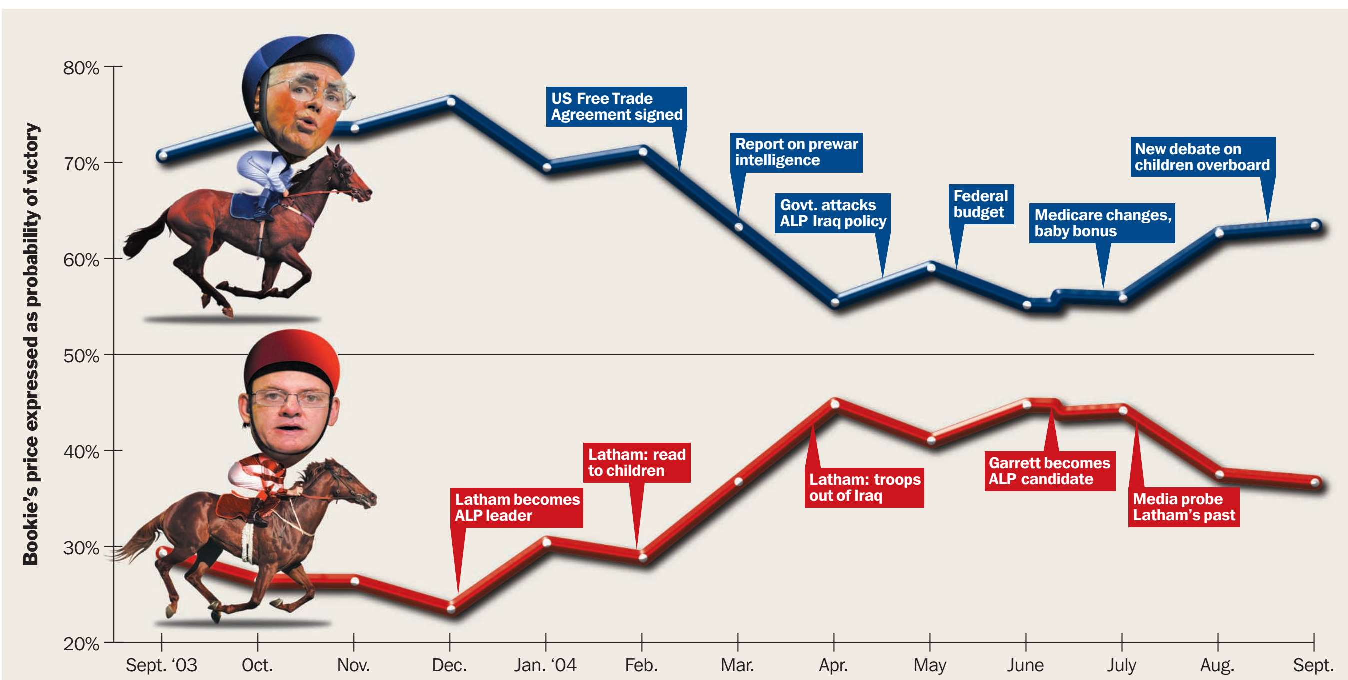
That's no mere fancy. In a study of the 2001 election, Wolfers and economist Andrew Leigh, of the Australian National University, found that while poll-sters differed on the outcome and the winner's vote share, punters' money was solidly on the government. And in marginal contests, the favorite won in 43 seats out of 47. Polls are certainly useful, Wolfers says. But "the media would serve the public better by reporting on betting rather than polls."

Early last century, before opinion polls were invented, the U.S. press tracked the ups and downs of a huge political-betting market centered on Wall Street. According to University of North Carolina economist Paul Rhode, bettors were remarkably prescient: in 12 presidential elections between 1896 and 1940, the underdog won only once. Today Americans can "wager" on elections online through the Iowa Electronic Markets, a small-scale futures exchange that lets people buy contracts on candidates based on their estimated chance of victory. (At press time, George W. Bush led John Kerry 54% to 46%.) Since its 1988 launch, the I.E.M. has outpredicted election-eve polls by an average of 0.5 percentage points.

Why should markets be better forecasters than polls? Economist Friedrich von Hayek argued that markets efficiently gather information held by widely dispersed people, summarizing it in the form of prices. In speculative markets, traders and bettors are rewarded only if they correctly predict future prices. That, Wolfers says, motivates them to get the best information they can, ignoring trivia and trends. "The market seems pretty highly attuned to news that affects the election outcome," Wolfers says. "That's not always the same as what the papers report. The market is unlikely to react to things like party conferences and policy speeches. But it will react to a change of tactics or a new campaign manager, which may not influence opinion polls."

Election punters and pollsters are both trying to figure out how the nation will vote. But when punters make that call, says Leigh, "they're putting their money where their mouth is." Pollsters must rely on what voters tell them. That can lead to error, says Leigh, because "you're sampling only a fraction of the population" and "people might say anything just to get rid of the interviewer." Overall poll results—percentages of the total vote—may not correspond to numbers of seats won. And in marginal seats, on which many elections turn, the margin of error can exceed the margin of victory. In '01, the betting markets' predictive power in these seats "really surprised us," says Leigh. "But the people who were betting on those seats knew them very, very well."

Markets aren't infallible, of course: Australian punters failed to predict the upset wins of Paul Keating in 1993 and Steve Bracks in 1999. And I.E.M. traders wrongly predicted in 2000 that Bush would win the popular vote as well as the presidency. In early July, Centrebet manager Gerard Daffy had several calls from people wanting to bet on the date of the election. He didn't open a book "for obvious reasons," he says. If he had, punters would have had another miss: "The date they were looking for was Sept. 18." —***By Elizabeth Feizkhah***



TRACKING: Betting "responds rapidly to occurrences that affect the dynamics of a race," says Leigh Sources: Andrew Leigh, A.N.U.; Centrebet

ILLUSTRATION FOR TIME BY GREG BAKES

Dough in know goes off Labor

By Justin Norrie
June 15, 2004

Don't bother with the polls. Ignore the pundits. The most reliable indicator of electoral success is apparently the punters, and since Peter Garrett entered the fray they've backed away from Labor.

A study by two academics in the US suggests betting odds provide a more accurate forecast of Australian federal election outcomes than opinion polls and economic modelling.

The authors - Justin Wolfers, an associate professor at Stanford University, and Andrew Leigh, from Harvard University - analysed odds offered by one of Australia's biggest bookmakers, Centrebet, at the last election. They concluded that "the press may have better served its readers by reporting betting odds than by conducting polls".

If that's the case, then Mark Latham's Labor is lagging behind the Coalition and has suffered a dip in popularity since former Midnight Oil frontman Peter Garrett was called up to the ranks last week.

"Labor is currently on $2, but Liberal is at about $1.70," said Gerard Daffy, sports betting manager at Centrebet.

"There was a huge flood of voting against Labor last week when Garrett came into the picture, so I think that might have been seen as a destabilising force that pushed the odds out. We've been taking bets on elections since 1993 and our odds have always predicted the winner."

When Mr Latham took over the ALP, Centrebet had the party as a rank outsider at more than $4, with the Coalition around the $1.50 mark.

Sports Acumen, a Canberra-based gambling agency, is offering $2 for Labor and has the Coalition slightly ahead at $1.80. TAB does not offer odds on elections.

"I reckon there will be two or three million gambled on this - it'll be the biggest gambling event of the year, bigger than all the sporting events," Mr Daffy said.

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The Sydney Morning Herald

Fri 29 Mar 2002

Punt the polls and place your bets with a bookie

Michelle Grattan

If you want to predict the winner in an election, don't worry about the polls. Have a look at the betting odds.

Seriously. A study by Stanford University's Graduate School of Business, concludes that, particularly in marginal seats, "the press may have better served its readers by reporting betting odds than by conducting polls".

Examining data from one of Australia's largest bookmakers, Centrebet, the study found the "betting market not only correctly forecast the election outcome, but also provided very precise estimates of outcomes in a host of individual electorates".

The study's authors – Justin Wolfers, an assistant professor of economics from Stanford, and Andrew Leigh, from the John F. Kennedy School of Government at Harvard – say their tracking of election betting is a first for Australia.

The betting was compared with the forecasting results for polls and economic models (which relate results to changes in indicators such as unemployment and inflation).

The odds on a Howard victory were the same on the first and last day of the formal campaign. The variations between suggested the campaign itself was an approximate draw, with Kim Beazley winning the first half and John Howard the second.

Centrebet also offered odds on the outcome in 47 electorates. The betting favourite won in 43. "Given that most marginal seats were in this sample, the fact that the market correctly selected in so many tight races is quite extraordinary," the authors say.

In three marginal seats where polls and betting could be compared, the polls were right in two and the betting market in three.

Centrebet offered another form of betting in 12 non-marginal seats, allowing punters to bet against "the line". For example punters were asked to bet on whether Mr Beazley's primary vote in Brand would be under or over 50.5 per cent, with equal odds offered on both results.

"In nine of these cases the closing odds were the same, whether betting on 'over' or 'under', suggesting the market suggested the line as an unbiased estimate of the likely outcome. These predictions were indeed extraordinarily accurate."

THE AUSTRALIAN Tue 02 Apr 2002

Punters' poll noses sharper than pundits'

Ian Henderson

PUNTERS are better than pollsters at predicting the results of federal elections, a study of actual and forecast election outcomes has found.

Two academics, who watched the odds offered by Centrebet on the November 10 election , said "the betting market not only correctly forecast the election outcome but (it) also provided very precise estimates of outcomes in a host of individual electorates".

Stanford University's Justin Wolfers and Harvard University's Andrew Leigh concluded "particularly in marginal seats, the press may have better served its readers by reporting betting odds than by conducting polls".

It's not that more conventional ways of forecasting election results — opinion polling and using economic data to predict voter intentions - are of no value.

Dr Wolfers and Mr Leigh, a former adviser to Labor senator Peter Cook, said Newspoll (published by *The Australian*) and AC Nielsen (published by *The Sydney Morning Herald* and *The Age*) "produced useful forecasts in the few days before the election".

But neither opinion polls nor economic models proved as sound as Northern Territory sportsbooks, Dr Wolfers told The Australian. Centrebet odds "in fact provided extremely accurate forecasts of the election results".

They found that in 43 of the 47 seats where Centrebet offered odds, the betting favourite won the contest.

English Translation (From the Finnish): With thanks to Erki Viirand

People Bet on the Next Chair of Keskusta (Finnish Centre Party)

The Australian bookmaking organisation Centrebet enables people to place bets on who will become the next Chair of Keskusta. Anneli Jäätteenmäki is the bookies' favourite with odds of 1.5:1; Olli Rehn follows with 2:1.

The odds for Jäätteenmäki moved from 2.35 to 1.5 due to a few large bets. Three Finns placed four-digit bets on her candidacy – 2,000, 1,329, and 1,000 Euros – and dozens of others have put significant sums on her, as announced by Centrebet.

The overall amount wagered exceeds 15,000 euros (nearly 100,000 Finnish marks).

In the beginning, Paavo Väyrynen boasted the best odds. Even now, he's third with a 5:1 ratio. Every euro wagered for Hannu Takkula or Matti Vanhanen would return 25-fold. Others on the ranking list include Seppo Kääriäinen, Esko Aho, and Mauri Pekkarinen, with respective ratios of 30, 65, and 75.

Stanford and Harvard, two of the world's most respected universities, recently published a study concluding that Centrebet predicts election results more accurately than professional public opinion polls, according to a Centrebet press release.

Justin Wolfers and Andrew Leigh followed Centrebet's odds during last year's Australian parliamentary elections. According to their study, the country's newspapers would have served their readership better had they published these odds, instead of public opinion polls, boasts the press release.

Centrebet focuses especially on sports betting, but the company's website also features wagers on special events, such as the new Chair of Keskusta or the winner of the Eurovision song contest. The company's home page is at www.centrebet.com.

Olli Riikonen

Olli.Riikonen@keskusta.fi

The Dominion Post (Wellington)
July 20, 2002, Saturday
SECTION: NEWS; NATIONAL; Pg. 2
LENGTH: 251 words
HEADLINE: Oz bookies offer odds on election

BODY:
NEWS an Australian betting agency is taking election bets has Labour Party president Mike Williams reaching for his wallet.

CentreBet, based in Alice Springs, favours a Labour minority government after July 27. It has posted odds of a $ 1.25 return for a $ 1 bet on Labour winning fewer than the 61 seats it will need to govern alone.

Mr Williams said he was attracted by Labour paying $ 3.20 to win 61 or more seats.

Polls over the past week indicate that is now unlikely.

He would place $ 100 on a Labour majority Government, Mr Williams said.

"I will certainly work out how to open an account there, and bet a hundred bucks," said Mr Williams, who described himself as a once a year punter.

He laughed off any hint it was unpatriotic to send New Zealand dollars to Australia, upsetting balance of trade figures.

"I could be criticised as being unpatriotic, but I'm going to get it back," he said.

CentreBet's Gerard Daffy said Labour was expected to cruise to an overall majority till last week's GE corn scare.

United States academics who studied betting markets on last year's Australian federal election found bookies correctly forecast the outcome.

"Stanford University's Justin Wolfers and Andrew Leigh of Harvard concluded that the Australian press should have published more betting stories and fewer polls," Mr Daffy said. -- NZPA

[Entertainment | ENTERTAINMENT]

Top documentary Alt Om Min Far, Borettslaget actor Robert Stoltenberg, Jeg Er Dina actress Maria Bonnevie and French flick Amelie are Centrebet's favourites for the four major Amanda Award categories at this year's Norwegian International Film Festival.

Alt Om Min Far, Even Benestad's movie about his transvestite father, is 1.50 to win the Best Norwegian Film prize. Tyven, Tyven is our second favourite at 2.75, with the Ole Bornedal-directed Jeg Er Dina $5.00 outsider because of its non-Norwegian screenplay.

Our film analyst believes that the Best Actor race is a two-way contest between television star Robert Stoltenberg and Jorgen Langehelle, nominated for his performances in Tyven, Tyven and Jeg Er Dina. Stoltenberg, extremely popular with the Norwegian public after the success of Borettslaget, is our favourite at $1.70. Kim Bodnia is $6.00.

Maria Bonnevie represents the best chance of Jeg Er Dina, arguably the most famous of the Norwegian films in foreign countries, winning one of the top gongs. Bonnevie is our $1.35 favourite and she is favourite ahead of Det Storste I Verden actress Kirsti Stubo ($3.75) and Tiden For Tim star Andrine Saether ($4.50).

The Best International Film category is very competitive. Amelie is the favourite at $2.30, with The Lord Of The Rings: The Fellowship Of The Ring ($2.50), A Beautiful Mind ($3.85), Shrek ($13), Bridget Jones' Diary ($13) and Harry Potter and the Philosopher's Stone ($17) making up the quality field.

[Politics | POLITICS]

Professional opinion pollsters believe that Gerhard Schroder cannot win next month's German election but Centrebet's market that acclaimed American academics rate above surveys, suggests that Germany's charismatic chancellor is recovering ground.

The majority of polls put Schroder's Social Democratic Party five percentage points behind Edmund Stoiber's Christian Democratic Union/Christian Social Union coalition, but punters think that the surveys are incorrect and are backing Schroder to win a second term in office. His chancellorship odds are now $2.50. Last week he was $3.60.

Betting support for Stoiber is drying up as the election campaign gets into full swing, although high-rolling punters are continuing to back the CDU/CSU alliance to win the most seats at prohibitive prices given their significant lead in the various polls. They do not, however, want to stake money on the Bavarian landing Germany's top job.

It seems Schroder is rallying because Germans approve of his stance on the issue of Iraq.

Academics at two of the world's leading universities published a comprehensive study in which they found that Centrebet's betting markets on last year's Australian Federal Election not only correctly forecast the overall outcome, but also provided incredibly precise estimates of outcomes in a multitude of individual electorates.

Stanford University's Justin Wolfers and Andrew Leigh, of Harvard, concluded that the Australian press should have published more betting stories and fewer polls.

[Soccer | SOCCER]

The big news around Centrebet this week was the 100% market we offered on last nights Champions League match between Rosenborg and Brondby, and didn't we get some response from the punting public! The amounts bet on this game were very similar to some of the World Cup matches, with one Norwegian client leading the way with a bet of 200,000 NOK ($AUD 40,000) on Rosenborg at $2. The draw

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STANFORD BUSINESS

STANFORD BUSINESS' MAIN PAGE

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August 2002, Volume 70, Number 4

Politics

Bookies, the Best Bet for Ballot Prediction

ON ELECTION EVE, political campaign managers wanting to know how their candidate or issue will fare could pay big money and call a pollster. Or better yet, suggests new research by Justin Wolfers, call a sportsbook. Especially if the race is tight.

ILLUSTRATION BY SARAH WILKINS

The press might better serve its readers by reporting betting odds than by conducting polls.

Wolfers, an assistant professor of political economy who as a youth worked for a bookmaker in his native Australia, followed a hunch about the predictive power of betting markets in forecasting the outcome of political elections. With Andrew Leigh of Harvard's John F. Kennedy School of Government, he coauthored a study examining the effectiveness of three tools for forecasting the outcome of Australia's 2001 federal elections: economic modeling, opinion polling, and betting odds.

While the study found that all three methods performed reasonably well, it introduced, for the first time in Australia, a new source of data for predicting elections—betting statistics from one of the country's largest bookmakers. The study's provocative conclusion is this: Particularly in marginal seats, the press might better serve by reporting betting odds than by conducting polls.

Wolfers sets the scene: "Throughout much of the election cycle the candidate on the left, Kim Beazley of the Australian Labor Party, had been expected to win as prime minister in the November election. John Howard, the incumbent and leader of the Australian Liberal Party, saw the tide turn in his favor in the days following the Sept. 11 terrorist attacks on America when the population rallied around its leader. At about the same time—so it's hard to untangle the two events—a boatload of Afghan refugees was found off the coast of Australia. Howard took a strong stand against allowing them to immigrate, while Beazley chose something in the middle ground and was perceived to be a weak leader. This was argued by many political commentators in Australia to be the turning point of the election."

When the election was held on Nov. 10, 2001, the Liberal-National Party gained 50.5 percent of the vote and John Howard was re-elected prime minister.

So, how did the three forecasting tools perform? In the medium term, which Wolfers identifies as one to two years out, economic modeling—based on predictions of how voters will react to various economic conditions—can be effective in picking the election-day winner. This is somewhat surprising, he notes, because election forecasting models have had mixed success, confounding political science researchers studying the impact of such economic indicators as unemployment and inflation on 18 postwar elections in Australia. However, if accurate economic measures are available, the forecasting power of economic modeling is quite substantial.

Using election-eve measures of economic indicators, Wolfers found that three econometric models performed extremely well, nailing precisely the predictions of an incumbent victory in one model and missing by 0.1 percent and 0.4 percent in two others.

Pre-election opinion polls should be more accurate in Australia than in countries like the United States, he points out, because voting in Australia is compulsory, eliminating the key variable of whether respondents will actually show up at the voting booth. Past experience indicates that opinion polls taken close to the election are quite accurate. Yet the lesson from Australia in 2001, like America's 2000 election imbroglio in Florida, points to the potential pitfalls of polling, particularly in very tight races. "The night before the election, Howard was ahead in two of three major polls," says Wolfers.

In contrast, data from Centrebet, Australia's largest bookmaker, demonstrated the impact of current events on the betting odds throughout the nine months leading up to the election by reflecting immediately the electorate's seesawing response to such events as leaders' televised debates and the Sept. 11 attacks on the United States. "By election day an enormous amount of money had been pumped into the betting market. More money had been bet on the election than on the football grand final, and Howard was the favorite with odds of $1.55, suggesting a 64 percent probability of his winning the election," says Wolfers. Howard won and Centrebet lost money on the election.

Digging deeper, Wolfers found the data yielded even more impressive results for oddsmakers. Centrebet also offered odds on the outcomes in 47 regional races. In 43 of 47 cases, the betting favorite won the election, even in the marginal seats. Moreover, in the three regional races where opinion polls had been conducted, the polls correctly predicted the winner in two contests; the betting market got all three right.

"The rationale for this happening comes from finance, which says that markets are efficient aggregators of information and equilibrium prices should reflect all available information," says Wolfers. "The data suggests the Australian betting market is extraordinarily efficient. And why not? There's a huge incentive for participants to do their homework, collect reliable information, and make sure the price is right."

Stateside, Wolfers anticipates political scientists will look closely at the rich data sources in the Las Vegas betting markets during the next major u.s. election. Anyone care to make a wager on it?

—HELEN K. CHANG

Three Tools for Forecasting Federal Elections: Lessons from 2001, Justin Wolfers, GSB Research Paper #1723, November 2001; *Australian Journal of Political Science*, July 2002

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Study: Betting Odds Better than Election Pollsters

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STANFORD, California--(Press Release)-- Stanford Graduate School of Business faculty member Justin Wolfers predicts that on election day next month Republicans have a 7-in-10 probability of gaining majority control of the House of Representatives and a 1-in-3 chance of taking both the House and Senate. The latter probability represents a tremendous increase over the 1-in-8 probability estimated in early September before the threat of war with Iraq drew out the hawks.

Traditionally, political pundits and campaign managers could pay big money for a pollster to return these kinds of odds. But new research by Wolfers suggests an intriguing alternative: Call a sportsbookie, especially if the race is tight.

Wolfers, an assistant professor of economics who as a youth worked for a bookmaker in his native Australia, followed a hunch about the predictive power of betting markets in forecasting the outcome of political elections. With Andrew Leigh of the John F. Kennedy School of Government at Harvard, he co-authored a study examining the effectiveness of three tools for forecasting the outcome of Australia's 2001 federal elections: economic modeling, opinion polling, and betting odds.

While the study found that all three methods performed reasonably well, it introduced, for the first time in Australia, a new source of data for predicting elections--betting statistics from one of the country's largest bookmakers. The study's provocative conclusion is this: Particularly in marginal seats, the press may have better served its readers by reporting betting odds than by conducting polls.

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So how did the three forecasting tools perform?

In the medium-term, which Wolfers identifies as one- to two years before the election, economic modeling -- based on predictions of how voters will react to various economic conditions -- can be

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effective in picking the election-day winner. This is somewhat surprising, he notes, because Australian election forecasting models have had mixed success, confounding political science researchers studying the impact of such economic indicators as unemployment and inflation on 18 post-war elections in Australia. However, if accurate economic measures are available, the forecasting power of economic modeling is quite substantial.

Using election-eve measures of economic indicators, Wolfers found that three econometric models performed extremely well, nailing precisely the predictions of an incumbent victory in one model, and missing by 0.1 percent and 0.4 percent in two others. "But in the real world, if it's the day before the elections, inferring indirectly off of things we know voters care a little bit about is not going to be as effective as going directly to the people and asking how they're going to vote," says Wolfers.

Pre-election opinion polls should be more accurate in Australia than in countries like the U.S., he points out, because Australia's compulsory elections eliminates the key variable of whether or not respondents will actually show up at the voting booth. Past experience indicates that opinion polls taken close to the election are quite accurate. Yet the lesson from Australia in 2001, like America's 2000 election imbroglio in Florida, points to the potential pitfalls of polling, particularly in very tight races. "The night before the election, Howard was ahead in two of three major polls," says Wolfers. "AC Nielsen was closest, predicting a 52 percent vote share for his Liberal-National Party, with Newspoll a close second, predicting a 53 percent share. Morgan polls were the most inaccurate, suggesting that Beazley's party would easily win the election."

Post-election commentators blamed the Morgan poll's error on its face-to-face data collection, compared to the other two that sampled voters by telephone. "Despite this missed target, the major polls were reasonably accurate on the eve of the election," says Wolfers. Six months out and longer, he cautions, polls lose their predictive power.

In contrast, data from Centrebet, Australia's largest bookmaker, demonstrated the impact of current events on the betting odds throughout the nine months leading up to the election, reflecting immediately the electorate's seesawing response to such events as leaders' televised debates and the Sept. 11 attacks in America. "By election day an enormous amount of money had been pumped into the betting market. More money had been bet on the election than on the football grand final, and Howard was the favorite with odds of $1.55, suggesting a 64 percent probability of his winning the election," says Wolfers. Howard won and Centrebet lost money on the election.

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Stateside this election season, Wolfers handicaps the U.S. Congress: "Republicans have about a 40 percent probability to gain a majority in the Senate, and 70 percent probability to control the House. However, the two are not independent events, and so the probability of Republican control of both houses is an average of around one-third, a dramatic rise from a low of around 1-in-8 at the beginning of September, which can be directly attributed to the threat of war in Iraq."

Anyone care to make a wager on that?

- October 01, 2002

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October 1, 2002

Betting odds may predict elections better than polls

On election day next month, Republicans have a 7-in-10 probability of gaining majority control of the House of Representatives and a 1-in-3 chance of taking both the House and Senate, predicts Stanford Graduate School of Business faculty member Justin Wolfers.

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The study's provocative conclusion is this: Particularly in marginal

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Election Time: What Are the Odds?

By Joanna Glasner

Story location: http://www.wired.com/news/politics/0,1283,55730,00.html

02:00 AM Oct. 16, 2002 PDT

People who criticize politicians for paying too much attention to the polls may have a point.

According to online wagering sites, would-be public servants could've predicted election outcomes a lot better by looking at the betting odds.

With the 2002 congressional election mere weeks away, campaign managers may heed that advice by perusing the Iowa Electronic Markets, one of the operations with the most experience processing wagers on U.S. voting results.

The site -- a nonprofit endeavor run by the University of Iowa's Tippie School of Business -- has provided a market since 1988 for traders to buy and sell contracts predicting U.S. election results. Currently about 17,000 people are placing trades for the November election.

"The central premise is that markets can reveal information about future events," said Forrest Nelson, an economics professor at the university and board member of the Iowa Electronic Markets.

So far, Nelson says the market has proven fairly accurate in predicting presidential elections. In the last four presidential contests, traders' predictions for candidate vote totals have come within 1.5 percent, on average, of the actual results.

Measuring the accuracy of congressional election predictions is a more complicated matter, Nelson said, because wagers are placed only on which party will gain a majority in each chamber. Because the election hinges on multiple state races, odds are harder to set.

In the November elections, the most favored outcome on the Iowa exchange is maintaining the status quo, with Democrats keeping control of the Senate and Republicans holding a majority in the House.

Traders view the second most likely result as a Republican majority in both chambers. A Democrat-controlled House and Senate ranks third, while a Republican Senate and Democratic House is seen as the least likely outcome.

The ranking hasn't fluctuated greatly since the market opened for election-related trading in July. Traders briefly pushed up the odds of a Republican Senate victory after Sen. Robert Toricelli (D-N.Y.) dropped his re-election bid. The odds reverted back to their earlier levels when former Sen. Frank Lautenberg stepped in to take Toricelli's place.

Thomas Rietz, a finance professor at the University of Iowa, believes market odds often prove more accurate than polling results because people are betting real money.

Although the sums are small (starting accounts require a minimum of $5 and a maximum of $500), participants do tend to be more thoughtful when "they're putting their money where their mouth is," Rietz said.

The market also tends to attract people who are genuinely interested in politics and therefore more likely to make informed decisions, Rietz said.

Justin Wolfers, a Stanford University finance professor, came to a similar conclusion in a study that examined the accuracy of bookmakers predicting the outcome of Australia's federal election.

In a survey of wagering on Australia's 2001 federal election, Wolfers found that the candidate favored by the country's largest bookmaker, Centrebet, prevailed in 43 of 47 contests.

Wolfers said no direct U.S. equivalent to Australia's political bookmaking business exists. Because online gambling is not legal in the United States, political bettors have limited options.

However, Wolfers believes even small-scale forums like the Iowa Electronic Markets, which operates legally as an education and research endeavor, provide a worthwhile snapshot of voter attitudes.

"It gives us a minute-by-minute history of campaigns," Wolfers said. "You can sort of see which sorts of events matter and which don't."

Among overseas gambling sites, it's far more common to see wagers on the presidential election than on the congressional race. Two online bookmakers, William Hill and Betfair, are currently taking wagers on which party will win the White House in 2004. (Both sites currently show the

Republican Party as the favorite.)

But Mark Davies, Betfair's spokesman, says very little betting activity tends to show up so far in advance. Most gamblers don't want their cash tied up for two years awaiting an election.

Davies said it's usually close to the eve of an election that the action picks up. One exception, however, was the 2000 presidential election, when bettors really started getting interested after the polls were closed.

While Bush and Gore fought over hanging chads and court appeals, bettors quickly jumped to their own conclusions. The day after the election, the odds predicted a Bush victory would be 10 times more likely than a Gore win.

Even at those odds, it turned out to be a winning bet.

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

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Terrorism futures, again

by John Quiggin on December 19, 2003

The idea that speculative markets can be used to forecast political events hit the headlines a while ago with the furore over terrorism futures. This idea is still around and the general claim that political events can be forecast by futures or betting markets is still being pushed hard. The main source of data is at the Iowa Electronic Markets, but there's plenty more. Reader Jack Strocchi sent me this report on a study of Australian betting markets and elections.

As it happens, I'd already looked at this and come fairly rapidly to the conclusion that the betting markets weren't much good, so I was struck by the money quote from author Justin Wolfers

> The data suggests the Australian betting market is extraordinarily efficient. And why not? There's a huge incentive for participants to do their homework, collect reliable information and make sure the price is right."

Looking at the report and also the Iowa studies, the evidence in support of this claim still seems very weak to me. In 2001, for example,

> The night before the election, Howard [the incumbent Liberal PM] was ahead in two of three major polls ….[on Centrebet] Howard was the favorite with odds of $1.55, suggesting a 64 percent probability of his winning the election,"

That is, on the crudest possible use of the polls, two out of three suggested a Howard win, giving odds almost identical to Centrebet. In fact, I doubt that any serious analyst would have given the Labor Opposition even a 25 per cent chance by election night.

To be fair, Wolfers doesn't put much weight on the election-night market. He says

> data from Centrebet, Australia's largest bookmaker, demonstrated the impact of current events on the betting odds throughout the nine months leading up to the election, reflecting immediately the electorate's seesawing response to such events as leaders' televised debates and the Sept. 11 attacks in America.

In fact, however, the betting markets reacted more slowly than the polls. In this piece written in September 2001, Wolfers and his co-author Andrew Leigh rated Labor a 55 per cent chancebased on the Centrebet data.

But enough of this *ad hoc* dispute. What test should we be applying here? It's not appropriate, as nearly everyone in this field has done, to treat polls and betting markets as separate predictions. Punters in the betting markets have access to the polls. So they should do at least as well, on average, as any mechanical rule based on poll data. The test "have the markets done better than the polls" implicitly compares the actual betting strategies to the rule "at even money bet on whichever candidate is ahead in the polls". Even compared to this simple-minded rule, the improvement shown by the markets is marginal at best.

The real issue we should consider, before rushing to embrace terrorism futures and the like, is how betting markets would perform in the absence of information from polls. You'd have to go back before World War II for this, but it's my impression that predictions of election outcomes in this period were often way off the mark

{ 35 comments }

1

John S 12.19.03 at 9:22 am

> Do betting markets do better than polls? I'm swayed by Hal Varian, an economist I think is worth listening to, and he likes betting markets. In any case, your counter-argument is useless in a situation where there are no polls. If there were so-called terrorism futures they'd have no polling equivalent. And I like the fact that betting markets allow anyone, including people who might have good reason to think the way they do, to have a say in the possibility of an outcome. In situations where there are no polls, I find betting markets a much superior approach to asking so-called experts what they think is going to happen. Finally, your suggestion that we are rushing to embrace terrorism futures is risible. You are trying to suggest you are a rebel on this issue; in fact, your view is orthodox.

2

dsquared 12.19.03 at 11:08 am

> Varian likes the Iowa electronic markets, but he hasn't done any actual work on them as far as I know. The entire question at issue is whether, in cases like terrorism, constructing markets would be a better use of resources than more conventional data gathering. I don't understand why you're putting words in Mr Quiggin's mouth; nowhere in his post does he claim we are "rushing toward terrorism futures". Finally on a general point, could I ask you to take a more polite tone with our guest commentator, please? We're having rather a crusade on civility in the comments section at the moment.

3

Nick 12.19.03 at 12:21 pm

> I'll posit a (perhaps too) simple explanation as to why I suspect terrorism futures would not work. If there is information in the market about a terrorist incident, people will want to bet on it and the odds will presumably shorten. But any decent terrorist organisation will monitor the odds of particular events. If the odds shorten on something that sounds uncomfortably close to what they're planning, surely they'd have the smarts to realise their plan was known and change it.

4

Nabakov 12.19.03 at 12:55 pm

> I raised the same point Nick the last time terrorism futures were discussed on CT and was rebutted in a reasonably convincing way. Unfortunately I can't remember the details (and can't be bothered sifting through archives) except that it was a rather counterintuitive arguement. The other way terrorists could benefit from such a market is by playing it themselves to raise the odds on particular events and then plunging(sorry) big based on their own inside knowledge. Speaking of which, did anybody ever get to the bottom of the suspicious flurry of airline options traded just days before 9/11.

5

John S 12.19.03 at 1:29 pm

Sorry dsquared and Mr Quiggins, I meant no disrespect. In fact, as this is an issue which interests me a lot I was delighted to see it raised again. Perhaps I was ruder than I should have been in my haste to defend what I think is a better idea than most people believe. One too, with a wider application than just terrorism. As for my putting words in Mr Quiggin's mouth dsquared, what can I say? Mr Quiggin writes "before rushing to embrace terrorism futures and the like" – that's not me putting words in his mouth, that's a cut and paste job. Now, I may have misinterpreted, but I read that as implying that there's a pent-up wave of demand for terrorism futures. The opposite is true in my humble view (I hope that it's not too rude of me to say so). There's no possibility of a rush to such markets as the debacle over the terrorism futures market in the US demonstrates. The problems with a terrorist futures market are exaggerated. If you think terrorists can manipulate such a market, restrict it to, say, the intelligence community or put a limit on the size of bet that can be placed. Sure, there may be problems, but don't dismiss the idea without tinkering to see if it can be made to work.

6

Nabakov 12.19.03 at 2:05 pm

"If you think terrorists can manipulate such a market, restrict it to, say, the intelligence community or put a limit on the size of bet that can be placed." But wouldn't that defeat the purpose of the exercise – which is to create real incentives for as many players as possible to collect and act on the widest possible range of relevant information? Applying the guidelines above would leave you with not much more than the office footy tipping pool.

7

John S 12.19.03 at 3:52 pm

"Applying the guidelines above would leave you with not much more than the office footy tipping pool." That may be true, at least for a terrorist futures market, but even that's better than the office manager alone deciding who's going to top the league.

8

Barry 12.19.03 at 3:54 pm

And, as has been pointed out in somewhere else, once it's restricted to the intelligence community, a huge number of bureaucratic factors come into play. Those who place bets disliked by the highers-up will be subject to retaliation from those higher-ups. Bets which reflect the inside information of specialists would come under fire for violation of the rules which govern the compartmentalization of intelligence. The whole point of a market would be that governmental/corporate chains of command are limited. The whole point of a governmental/corporate chain of command is that internal markets are limited.

9

Barry 12.19.03 at 4:06 pm

Another problem – if participants bet on certain things happening, which they (with good reason) know to be likely, those things should become less likely. That's the reason for the market. Which means that the people who bet on those things happening are scr*wing themselves by doing so – unless they are small players, who won't shift the market by their actions. However, in that case, they should be ignored, since there will always be somebody betting on anything. For example, if I were one of a large number of people bet on attacks against the energy system in the US, the government should shift efforts to preventing those attacks. Which would cause me and the others to have a lesser chance of making a profit. If I were one of a small number of people who bet on something, then the government should not pay a lot of attention to me – so the information is not very useful. And if that particular thing did happen, I'd get a short vacation to Gitmo long before I got the profits. Things which are likely, but unpreventable shouldn't find as many takers for their non-occurrence (and that information is less useful to the government).

10

John S 12.19.03 at 4:14 pm

No Barry, not if bets are anonymous. If they're anonymous, even a limited market will reveal the best guess of the entire community. Presumably, the only reason to create such a market would be to try to find that best guess. If the administration insists that it knows who bet what, yes that will distort the results and return intelligence assessment to the status quo. But why go to all the bother of creating a market then?

11

due torre 12.19.03 at 4:14 pm

I thought the T(errorism)FM was supposed to be like the (succesful, AFAIK) sales futures market HP set up internally a few years back. The idea behind that was that individually, sales managers would be overly optimistic on their projected sales for the quater, and those numbers agreggated would produce overly-rose projections for the company as a whole. By allowing managers to (anonymously) put money on what they expected sales to be, HP's front office came up with a much more accurate prediction. Translating this to the intelligence field, the idea behind the TFM would be that analysts (the 'managers' of intelligence, if you will) are currently pressured to shade intelligence so that it makes the front office happy. By allowing analysts to bet on the TFM (and by keeping those numbers internal), the administration could get assessments more honest than those coming out of Cheney's office… In this case, terrorists, like HP's clients, not only wouldn't be able to bet on the TFM themselves, they wouldn't know what level predictions are trading at, so as to call off impending attacks that have been detected and "priced in" to the market. My concern with the TFM is that unlike the IEM or HP's sales market, it is not pricing trends (sales or polling data) but discrete events. The closest analogy I can think of in the markets is that of trying to price bankruptcy. While there is a market for that (I would argue the bond market), recent history has shown that following the big three rating agencies rating of corporate bonds is a poor indicator of upcoming bankruptcy… well that was longer than i planned it to be…

12

due torre 12.19.03 at 4:16 pm

sorry for the typos in the previous. not enough coffee this morning…

13

John S 12.19.03 at 4:33 pm

Barry, small players can shift markets. Not individually, true, but collectively. And whoever thought, no I won't buy that ridiculously cheap whatever, even though I know it's worth much more, because everyone else will have the same idea as me and so soon it won't be ridiculously cheap anymore?

14

Barry 12.19.03 at 5:06 pm

John S, that's true – a large number of small players can shift the market. I don't understand your last sentence, but if it's what I think it is, the terrorism futures market should work the opposite way – once the other investors pile in, the profits should go down, even for the early buyers. The anonymity – this was in reference to comments that terrorists could game the market, to which it was suggested that the market could be restricted to the intelligence community. In theory, untraceable but restricted access could be granted, but in the real world trusting that would be a major act of faith. Due torre – D^2 had a post which mentioned the use of 'internal markets'.

15

Decnavda 12.19.03 at 6:04 pm

"The real issue we should consider, before rushing to embrace terrorism futures and the like, is how betting markets would perform in the absence of information from polls." Why on earth is this the "real issue"? I support futures markets, and think they give better info than polls, and I can your answer: Without polls, the futures markets would perform much worse. So what? Futures are information amalgamation techologies. The better the information, the better the amalgamation. You need both. This is a way for a non-expert to get an accurate picture of the expert's conventional wisdom. The experts themselves probably should not rely on the futures, but on the data. But a reader of a newspaper story that prints any one of the three polls on Howard would get a skewed view, whereas if the reported cited the futures market, the reader gets the views of everyone willing to stake money. The CEO's of HP are not experts in projecting sales, but they need accurate info. Their market keeps their experts honest. Elected officals need accurate information on security threat where they are not experts and the relavant experts may have reasons to skew the views they present to the officals. In a democracy the ultimate decision makers are the citizens, who are notoriously non-exerts. The polls vs. futures is a false delima. Experts need data, and that it not the futures market. Non-experts need honest expert opinion, and that is the futures market. Analysis of futures markets I have read suggest that they are extremely effective, unless the true odds of an event are less than 10% or greater than 90%, in which case a bias to overesimate longshots creeps in. This would suggest that futures designed to predict specific events – say, will the Isreali PM be assasinated next year – would tend to be over valuated and the market would be ineffective. But make it more general – say betting on the number of Isreali citizens killed in terrorist attacks next year – and it should be extremely accurate. Finally, what kind of marketing idiot came up with the term "terrorist futures"? Couldn't your average government employee come up with "security futures"?

16

dsquared 12.19.03 at 6:34 pm

Analysis of futures markets I have read suggest that they are extremely effective, unless the true odds of an event are less than 10% or greater than 90%, in which case a bias to overesimate longshots creeps in Not true; my favourite statistic is the one which drove the plot of the film "Trading Places", that 40% of the volatility in the NYMEX orange juice futures contract happens on the day that the Department of Agriculture releases its orange crop forecasts.

17

James Surowiecki 12.19.03 at 6:40 pm

I, too, am a bit confused by the argument about polls. The Iowa Electronic Markets has never involved more than 800 traders, I think. (It may have become bigger this year because of all the publicity.) It costs basically nothing to run, and there's very little money at stake. And yet between 1988-2000, it did better than the polls 75% of the time. That is, comparing the IEM's forecast to a poll's on the day the poll results were printed, the IEM was more accurate three-quarters of the time. The results are less volatile, and are more accurate the further back you go. I don't really see what is unimpressive about this performance. Mr. Quiggin's post also focuses only on the "who will win" contracts. But the IEM also offers "what percentage of the vote will a given candidate get" contracts, and the performance of those contracts has been, if anything, better. In the California election, the market was only about 1% off (in absolute terms) in its prediction of the recall vote, Schwarzenegger's percentage and Bustamante's percentage. No doubt without polls the IEM would perform much worse. But I have little doubt it would be better than any other mechanism you might devise to predict election outcomes.

18

James Surowiecki 12.19.03 at 6:46 pm

One other minor point, which I made too often at the time of the initial uproar over PAM (apologies for repeating myself): the vast majority of the contracts that would have been offered on PAM and I believe will be offered by NetExchange did not have to do with discrete events. They had to do with changes in civil, military, and economic conditions in the Middle East. This was the point of PAM's partnership with the Economist's Intelligence Unit. Indices of civil stability, military preparedness, and economic health would have been constructed, and the contracts would have been pegged, effectively, to changes in the indices. There would have been some contracts offered in discrete events—like, say, a coup, I gather—but they would have been more the exception than the rule. The other innovation that NetExchange was/is planning to offer was combinatorial contracts, which would have attempted to evaluate how changes in one country would influence or be influenced by changes in another.

19

decnavda 12.19.03 at 6:56 pm

dsquared- I was refering to an anlysis I read of idea futures markets, not commodites futures, although I recognize that the dynamics should be essentially the same. When I saw the movie, I assumed that the Department of agriculture had acess to information that investors would not. Is this wrong, or do the investors really just trust the government experts to make better predictions than private experts?

20

Jeremy Osner 12.19.03 at 9:38 pm

Has anyone had the idea yet of a Patents Futures Market? You would buy interest in not-yet-invented machines—inventors could use the market to hedge themselves like farmers use Commodities Futures. Maybe?

21

Decnavda 12.19.03 at 9:43 pm

jeremy- There are a ton of Science & Technology claims traded at Forsight Exchange. It's play money, but yes, people have thought about it.

22

John Q 12.20.03 at 12:40 am

To try and clarify my main point, I think the evidence is that prices in betting and futures markets do not add a lot of information to what's in the polls. If you grant that, then in a situation where there are no public sources of information comparable to polls, prices will not contain much information. Coming back to the Iowa Markets, the analog of the weak efficient markets hypothesis is that the market should do better than any estimate that can be derived from polling data (including past elections). The test mentioned above, outperforming a single poll on the day it is published, is much weaker than this, since it ignores all the evidence from previous polls. Especially where samples are small, you would a weighted average of recent polls will typically do better than the most recent poll.

23

Decnavda 12.20.03 at 1:00 am

john q.- 1. No, the markets do not ADD information, they synthasize expert opinions. 2. Without polls, markets would still provide the BEST predictions, although, yes, they might still not be very good. 3. Weightiing the averages of past polls is a job for experts, who will no doubt disagree as to how to weight them and how far back to go. As a non-expert, I do not know how to judge between them of pull out enivitable baises. Again, if you are arguing that these markets do not provide much useful information for experts, I would probably agree. But I think they are the best way for a non-expert decision maker to see the most honest synthasis of expert opinion.

24

James Surowiecki 12.20.03 at 3:50 am

John, I think you are holding the IEM to an effectively impossible standard. If the polls are relatively accurate, how could the IEM add (I would say "aggregate") lots of information that's not in the polls? In other words, even if there is all this relevant private information or analysis that the IEM is, in fact, aggregating, its effects may be going unnoticed because the polls are, relatively speaking, pretty good. In U.S. presidential elections, the IEM's forecast has been off, on average, by 1.37% in absolute terms (I'm citing from memory here, so I may be slightly off), which is yes, better than the polls. Certainly the market could do better. But I don't think it would be mathematically possible for it to do better enough to satisfy what you seem to be looking for. What this means is that your second point (prices would contain little information if there were no public sources) does not follow from your first (your evaluation of the efficiency, or lack thereof, of the IEM). In fact, it's possible that the less accurate the public sources were, the more valuable something like the IEM would be, because there would be more room for forecasting improvement. In any case, what we know is that the IEM is better than any public source we have (although I'd be happy to see how a weighted-average of polls would do). It seems curious to conclude from this that markets are therefore useless as information-gathering mechanisms. We also know that sports pari-mutuel markets and odds markets, which operate on the same basic principle as the IEM, are relatively efficient. At least in sports like horse-racing and professional football, it is very difficult, if not impossible, to find a systematic means of making better predictions than the market, and in horse-racing, the final odds on horses are relatively reliable predictors of final outcomes. By the way, I don't really believe that the point of a market is to synthesize expert opinion, at least not in the traditional sense. If you look at the makeup of the IEM traders, especially in the early days, it's not clear that there were that many experts. I think the reason to have markets like the IEM is that we don't know, in advance, who has information that might be relevant. The market provides an incentive for people who might have that information to reveal it.

25

John Q 12.20.03 at 8:03 am

James, you have a point, but I think the Australian evidence is relevant here, because the odds changed radically over the year leading up to the campaign, making a comparison easier than in the case when both estimates are very accurate. As the link I put up shows, the betting markets did worse than either the polls or expert opinion in absorbing new information.

26

John S 12.20.03 at 9:50 am

"the betting markets did worse than either the polls or expert opinion in absorbing new information" … which means you're suggesting that market participants can be systematically wrong. I find that hard to believe because such a situation immediately opens up a profitable opportunity for someone to exploit. And what is the expert opinion you're comparing betting markets with? Here you're suggesting that there are individuals who can do a better job than markets, the classic argument for planning an economy rather than leaving markets to do their work. And what about a situation where there are no polls?

27

James Surowiecki 12.20.03 at 9:57 am

John Q., judging from the Wolfers/Leigh 9/30/01 article, the Australian betting market does seem in September to have been relatively slow to incorporate new information relating to the overall popular vote. But to me, the most important piece of data in the original Wolfers and Leigh paper is this fact: the betting market called 43 of 47 individual races, including what W and L call "most marginal seats," rights. In most of these races, they say, polls were not available (though of course the national polls would be relevant)—and where they were, the betting market outperformed the polls. And the betting market called got the "over/under" line on candidates' vote shares right in 12 of 12 elections, again in the absence of local polls. That seems to suggest some measure of information aggregation outside of public sources may have been going on. I do think that the way Centrebet seems to have set up the betting is probably not the best approach, and may have something to do with why the market reacted slowly in September. Ideally, you'd like to aggregate all of bettors' opinions into one number (like the point spread in an NFL game, or the price of a stock), or run a parimutuel system, rather than maintaining two distinct betting pools. In theory, simple arbitrage should make these approaches two systems the same, but the second system is more likely to yield flawed results, because the bettors in each pool (that is, those betting on the Coalition or on the ALP) are likely to be less diverse than a healthy market needs them to be. In the same vein, the IEM would probably be more accurate if it allowed shorting, which I don't believe it does.

28

James Surowiecki 12.20.03 at 10:07 am

John S., although I obviously completely agree with you about the value of markets as information-aggregation mechanisms, it seems pretty clear, as evidenced most recently by the performance of the U.S. stock market from 1999-2001, that the market's judgment can be wrong for a sustained period of time, even though its wrongness creates, in theory, a profitable opportunity for investors to exploit. Saying markets work well at forecasting the future, and that on the whole they will offer better forecasts than, in this case, polls, doesn't mean that there are not times when the polls will be more accurate, as seems to have been the case in Australia in the wake of the Tampa incident and 9/11.

29

dsquared 12.20.03 at 1:33 pm

James, a couple of points: 1. There very definitely are systematic ways of making money on pari-mutuel horse racing and football betting. They're called the "home team effect" and the "long shot effect" and they're statistically very well established. Check out Burton Fabricand's book on "The Science of Winning" for horse racing; I think Ed Thorp's done one or two things on football. 2. I question the assumption of even weak-form efficiency in these markets; a casual look at the IEM market in the Democratic nominations, compared with http://www.tradesports.com's market in the same race reveals a number of arbitrages.

30

James Surowiecki 12.20.03 at 3:39 pm

The overbetting of longshots (and mild underbetting of heavy favorites) is a well-established inefficiency, which I tend to think is a function of the fact that gamblers have a local preference for risk. And it seems to be the case that the effect is strongest in late races, when bettors are taking a flyer looking to go home a winner. Whether you can systematically make economic profits taking advantage of this is another question. In this case, I think a concern with academic definitions of perfect (even perfect weak-form) efficiency obscures more than it clarifies. What interests me about parimutuel betting is that, even with the slight bias against heavy favorites, win-pool shares generally provide an excellent prediction of the outcome of races—that is, favorites win most often, place horses second most often, etc.—and the subjective probabilities of victory assigned by the bettors are generally close to the objective results (in terms of how often 3-to-1 horses win, etc.). I don't see the point of discounting that degree of performance because there is this one systematic inefficiency (which is only exploitable in a tiny fraction of races). As far as pro football goes, I've never found anything written by Ed Thorp on it, other than a chapter on using the Kelly Criterion to bet. But I don't think there is a "home team" effect in NFL betting. A recent historical study of the results of a straight "always bet the home team" rule found that, although successful slightly more than 50% of the time, it "has not won often enough to compensate gamblers for the required vigorish." (Obviously, betting the road team would, therefore, not work either.) When inefficiencies are found, they're usually quite limited in scope (they also tend to be present late in the season, suggesting that something similar to the longshot effect may be at work). One recent paper that seems rigorous found that betting the home underdog in weeks 15-17 would be a very profitable strategy. (Of course, this strategy was only documented retrospectively.)

But even this author argues that "in aggregate, market prices are very close to true values." Again, all I'm really interested in is whether markets offer a forecast that is, on average and over time, the best one available. In pro football, it seems to be that at least three-quarters of the time.

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robin green 12.22.03 at 8:35 am

The trouble with a generalised Ideas Futures market is that can involve ideas which are: (a) seemingly impossible to make rational predictions about – and you're not going to get a rational collective prediction by mushing together a bunch of irrational individual predictions or (b) subject to significant information inequalities, which don't tally with power inequalities among traders, or even straddle traders and non-traders (people who know something but don't participate in the futures market). In other words, if a little player knows something really useful but doesn't tell anyone else, he may make a prediction but be completely swamped by everyone else stampeding in the opposite direction. What's the alternative? To (a): stop expecting predictions of specific dates for highly uncertain developments, for example. To (b): realise that experts sometimes make better predictions because they sometimes have information (or intuition born from not easily distillable experience) that can't or won't be freely released to the market. Solution (b) seems to be really obvious, and (a) even more so. I don't understand why Robin Hanson and his free market coreligionists don't get these things.

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robin green 12.22.03 at 8:47 am

Oh, and my favourite contemporary counterexample to stock market fundamentalism: SCO's stock price fluctuations as abysmal indication of its lawsuit prospects against IBM, and indeed its prospects for survival. This will I think show that even when expert analysis (that is, expert relative to know-nothing investors) is *"freely available"* to markets, they can still get it wrong if they don't listen, and particularly if the media doesn't listen.

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John S 12.22.03 at 9:37 am

robin green, "…realise that experts sometimes make better predictions because they sometimes have information (or intuition born from not easily distillable experience) that can't or won't be freely released to the market" Like the experts who dreamt up the Stability and Growth Pact for the euro? I think Hanson is interesting which makes me, I take it, a free market coreligionist; on the other hand, you must be an undemocratic elitist because you believe policy making is best left entirely to the professionals.

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James Surowiecki 12.22.03 at 10:34 am

No one here believes that markets never get things wrong, so bringing up examples of mispricing isn't going to move the discussion along. The question isn't whether sometimes a small group of "experts"—assuming, for argument's sake, that you know who they are and are not— can make better predictions. It's whether they can make better predictions more often than markets (or whatever mechanism for aggregating people's judgments you want to use). The evidence, to me, suggests that they can't. You cannot use perfection as your standard for whether or not markets are smart unless you're going to use the same standard in evaluating your experts. As for SCO, do you honestly think the volatility of the stock price of a small company whose entire future cash flow depends on the outcome of an often arbitrary and capricious legal process is a good argument against the relative efficiency of markets?

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robin green 12.23.03 at 10:51 am

John – I never claimed that. Please stop putting words in my mouth. I only said that sometimes experts might know better than a whole bunch of non-experts, and that experts don't always tell non-experts what they know – not, I hope, a controversial starting point. And no, by "free market coreligionist" I meant someone who draws grand conclusions about the power of markets based on over-simplistic theories – and refuses to listen to reason.

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