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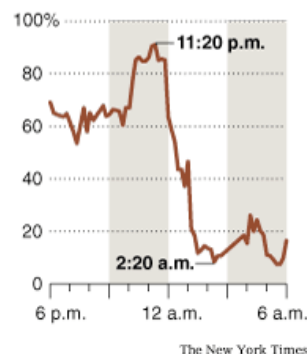
Odds Are, They'll Know '08 Winner

By DAVID LEONHARDT Published: February 14, 2007

On Election Night a few months ago, Betsey Stevenson and Justin Wolfers gave a small party for neighbors and colleagues at their row house in Center City in Philadelphia. They connected their television to a projector, served beer and pizza and watched the returns come in.

Political Futures

Odds that the Republicans would keep control of the Senate, over the course of Election Night 2006, from the betting site Intrade.



The party went strong until almost midnight, when the results started to seem clear. The Democrats had won the House of Representatives, according to the television networks, but would apparently fall short of capturing the Senate. On MSNBC, Chris Matthews was saying that "it looks good" for Senator George Allen, the incumbent in Virginia, whose victory would have ensured a Republican majority. On Fox News, Michelle Malkin reported that a number of blogs had declared Mr. Allen to be the winner.

So Ms. Stevenson and a couple of the guests said they were going to call it a night. But Mr. Wolfers, who had his laptop open in front of him, suggested that everyone stick around a little longer. In addition to the television, he had been following Intrade.com, a Web site that allows traders to bet on politics and other current events, and he noticed that the posted odds of the Republicans keeping the Senate were suddenly falling.

Those odds are based on the collective opinion of the traders, just as most any market price is, and at 11:50 p.m. they gave the Republicans an 85 percent chance of holding on. At midnight, the odds were down to 65 percent. Around 12:25 a.m., they fell below 50 percent.

A little before 1 a.m. — with the Intrade odds at 37 percent — CNN broadcast a live interview with John Aravosis, a liberal activist. "We pretty much know where we are," Mr. Aravosis said. "The Dems have the House. Republicans have the Senate. And, you know, I don't think that's going to change by morning."



A Discussion With Justin Wolfers (mp3)



Justin Wolfers's Research on Prediction Markets: An Introduction

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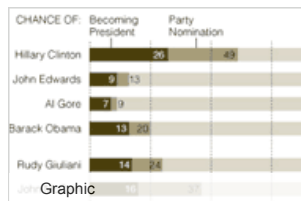
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It did change, of course. Mr. Allen soon conceded, and the Democrats began planning their majority. Mr. [Wolfers](#), an economist at the Wharton School of the University of Pennsylvania, sitting in the comfort of his living room, had been a better pundit than most of the professionals on television, thanks to a Web site that is based in Ireland.

Over the last few years, Intrade — with headquarters in Dublin, where the gambling laws are loose — has become the biggest success story among a new crop of prediction markets. Another company, Newsfutures, helps the world's largest steel maker, Arcelor Mittal, run an internal market on which executives predict the price of steel. At [Best Buy](#), a company called Consensus Point has helped start a market for employees to guess which DVDs and video game consoles, among other products, will be popular. [Google](#) and [Eli Lilly](#) have similar markets. The idea is to let a company's decision-makers benefit from the collective, if often hidden, knowledge of their employees.

But there's a broader point here, too. For a couple of centuries now, long before Intrade or even the Internet existed, financial markets have been making it easier to bet on what the future will bring.

In the mid-1800s, contracts tied to the future price of wheat, pigs and other commodities began to change hands. In 1972, the [Chicago Mercantile Exchange](#) introduced futures for foreign exchange rates. Treasury bonds tied to the future rate of inflation came along in the 1990s, and last year, the Merc began selling [contracts](#) based on the direction of house prices in 10 big metropolitan areas.

In every case, the market price reflects the sum of the traders' knowledge — about the extent of the housing bubble in Los Angeles, for instance, or the likely size of next year's wheat crop. This market price usually ends up being a more reliable forecaster than any individual, even an expert, can be. [In a nifty 2004 book](#), James Surowiecki gave the phenomenon a catch phrase: "The Wisdom of Crowds."

[N. Gregory Mankiw](#), a former adviser to President Bush, who has written about Intrade on his blog, explains it this way: "Everybody has information from their own little corner of the universe, and they'd like to know the information from every other corner of the universe. What these markets do is provide a vehicle that reflects all that information."

Once traders have the information, they can react to it by tweaking their portfolios. Corporate executives can do the same with their business plans, and Federal Reserve officials can do it with interest rate policy. In his [speeches](#), [Ben S. Bernanke](#), the Fed chairman, often talks about what forward-looking bonds are saying about people's inflation expectations.

As with most changes, this one comes with at least one big downside. The new market-based crystal balls seem to have made investors confident enough about the future to take on riskier and riskier positions, and some of them are almost certain to end badly.

But there are also enormous benefits to the new markets. Armed with better information, companies are less likely to be forced into a sharp cut in production and Mr. Bernanke is less likely to raise interest rates unexpectedly. Partly as a result,

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[recessions](#) now seem to occur about once a decade, rather than once every five years.

Intrade, in other words, isn't just an entertaining Web site. It is the latest iteration of one of the most important economic developments of modern times.

It has also been remarkably clairvoyant. Heading into the 2004 presidential election, Intrade's odds correctly forecast the outcome in all 50 states. The [2008 election](#) is far enough in the future that the current odds probably aren't as telling. But they are still worth considering, especially because early odds have had a better forecasting record than early polls in recent years, says Mr. Wolfers, who spends much of his time studying prediction markets.

The odds are starting to get more attention from political buffs as well. When [Lawrence H. Summers](#), the former Treasury secretary, was asked after a recent dinner speech what he thought about the campaign, he began reciting Intrade's betting line.

Intrade now makes [John McCain](#) the favorite for the Republican nomination, followed by [Rudy Giuliani](#). For the Democrats, [Hillary Rodham Clinton](#) has about a 50 percent chance of being the nominee, more than twice as much as anyone else. The most counterintuitive forecast is that Mrs. Clinton is given a better-than-even chance of winning the general election if she is nominated, while Mr. McCain — perhaps because he wants to keep fighting the war in Iraq — is not.

The main point, though, is that however the numbers change over the next two years, people whose business depends on politics would be foolish to ignore Intrade again. Knowing Intrade's track record, wouldn't you watch the television network that included the odds in its 2008 Election Night coverage? And if none of the networks did, wouldn't you turn to your laptop?

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