ACTIVITY 1

HOW ARE OPINION POLLS AND OPINION MARKETS DIFFERENT?

Directions: Read the following information. Then answer the Questions for Discussion.

Predicting Results by Conducting Public-Opinion Polls

Public opinion polls are a staple of American life. They are used to obtain information about a wide variety of questions, from what people want for breakfast to which candidate they support for president. Polls used to measure voter preferences have become very sophisticated, making use of several techniques developed by social scientists. National polling companies use these techniques to make their polls more accurate and unbiased. Here is an overview of some of the techniques.

Sampling

One major challenge for pollsters is to identify a random sample of voters. This cannot be done by talking to people in a shopping mall or asking people to call in to a television station. Probability sampling is the basis for all scientific survey research. The basic idea is that a small, randomly selected sample of a population can represent the opinions of all of the people in the population. The goal is to obtain the same results that would have been obtained had every member of the population been included in the survey.

Sample Size

Random selection of a sample is one issue polling companies face; sample size is another. For every poll, pollsters must determine how many interviews to conduct to insure that an adequate cross-section of randomly selected people will be included. It is not always necessary to work with a large number of people. A relatively small sample can represent a larger population adequately, provided that the sample meets other criteria for representativeness. In fact, a typical sample used in many national polls is 1,000.

Telephone Surveys

Pollsters use sophisticated computer programs to identify telephone numbers for the people to be included in a sample. Survey callers usually try to reach an adult living in the households identified by these numbers. Here, a certain sort of bias can be a problem. When there is no answer or the number is busy, the number typically is kept on file and called again later in the survey period. Pollsters use this re-dial procedure to correct for errors that could otherwise affect poll results, depending on who is at home at certain times. For example, older adults are more likely than others to be home at night. Younger single adults are less likely to be at home in the evening. Without the re-dial procedure, responses from younger voters might be underrepresented in the survey data.

Writing Good Questions

Writing good questions is hard. It requires a great deal of skill and experience. It also requires a determination to avoid introducing bias. The order in which questions are asked and the manner in which they are stated can affect the responses given. For example, in calls regarding a presidential race, it makes a difference whether the caller does or does not mention the party affiliation of the presidential candidates. Failure to mention party affiliation might bias the response. In some polls, like those commissioned by interest groups, people influenced by the wording of questions may guess at the expected answer and provide it.

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Lying, Voter Turnout, and Dollars

Pollsters face other problems as well. Some respondents lie to pollsters who call them, thus introducing error in the survey results. And while pollsters strive to obtain random samples of likely voters, it is extremely hard to predict who will in fact show up at the polls. For example, in the 2004 election, it was expected that more young people would vote than actually did. This expectation may have caused some polls to err by picking Senator Kerry over President Bush. Finally, it is expensive to conduct polls properly. It costs thousands of dollars to take all the steps needed to try to get things right. What if someone could get results of equal quality—or better results— without all the hassle and expense?

Predicting Results by Using Future Markets

There is an alternative to polling—a completely different approach to predicting elections. It involves using a political futures market. Trading in political futures involves none of the problems— statistical sampling, question design, and telephone contacts—that arise in opinion polling. Instead, futures markets allow interested individuals to make their own predictions regarding the outcomes of elections.

The Iowa Electronic Markets (IEM)

One example of a political futures market is the Iowa Electronic Markets (IEM). The IEM was developed in 1988 by three professors (Forrest Nelson, George Neumann, and Robert Forsythe) at the University of Iowa. It is a real-money, small-scale futures exchange. It allows individuals to buy and sell contracts reflecting their predictions about all sorts of events, including presidential races.

The IEM has various uses. It enables researchers to study market-based approaches to predicting outcomes. It also serves as an educational tool. It operates as part of a not-for-profit organization. No commissions or transaction fees are charged. Although the IEM is under the regulatory purview of the Commodity Futures Trading Commission (CFTC), it is not regulated by the CFTC or any other regulatory authority.

A futures contract is a legally binding agreement to buy or sell a commodity or financial instrument at a set future date. The price of the contract is determined by the bids of buyers and sellers in the market. The IEM operates something like the CME Group, a large futures contract exchange headquartered in Chicago. The CME Group enables people to buy and sell commodities like corn, wheat, and soy beans at a particular future date. It also permits the buying and selling of futures in certain financial instruments, including U.S. Treasury bonds and U.S. Treasury notes. Unlike the CME Group, however, the IEM is a *political* futures market where people can speculate on election results, using small amounts of money.

How does the IEM work? Let's imagine that it is the summer of 2020. The election of the U.S. president will take place on November 3, 2020. The IEM has just opened its "winner-takes-all" market where contracts for the presidential candidate with the largest share of the popular vote pay one dollar ($1), while contracts for the losing candidate pay nothing. You wish to buy a contract because you think you can predict who will win the contest between Candidate A and Candidate B.

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You contact the IEM website (www.biz.uiowa.edu/iem/) and open an account. (The most you can spend at IEM is $500.) The latest price for a futures contract on Candidate A is 62 cents. The price usually fluctuates, sometimes quite a lot, up until Election Day. With a Candidate A contract priced at 62 cents, Candidate A is considered to have a 62 percent probability of winning the election. If you buy a Candidate A contract and Candidate A does indeed win the election, the contract will pay you one dollar ($1) after the election. If Candidate B wins, you get nothing.

Let's say that you buy 500 Candidate A contracts at 62 cents each, for a total cost of $310. If Candidate A wins, your contracts will be worth $1 each, for a total of $500, giving you a gain of $190 on the $310 you spent. Of course, if Candidate B wins, you will lose the $310.

A second type of contact, the "vote share" market, is also offered by the IEM. If you buy a contract for Candidate A in this market, it will pay you a return based on the share of the (two-party) vote that Candidate A wins in the election. For example, if Candidate A wins 65% of the vote, then you will receive 65 cents. Suppose you buy 500 Candidate A contracts at 50 cents each, for a total cost of $250. If Candidate A wins only 40% of the vote, you will receive 40 cents a share or a total of $200, losing $50. Of course, if the final vote share is 70%, you would receive $350, winning $100.

The two markets differ in how the contract prices can be interpreted. The contract price in the winner-take-all market reflects a candidate's probability of winning, while the vote-share market reflects the candidate's anticipated vote share.

QUESTIONS FOR DISCUSSION

1. What are two challenges that public opinion companies face in their efforts to get accurate results? Explain your answer.

2. As a means for predicting the outcomes of presidential elections, how does the IEM work?

3. What is a futures market (such as the futures markets overseen by the CME group)? How is a futures market like the IEM?

4. Why might the IEM produce better results than traditional public opinion polls?