LECTURE NOTES: EMGT 234

UNCERTAINTY MODELING
THE SIMPLEST RISK ANALYSIS MODEL

\[ p = \Pr(\text{Accident during a Mission or Movement}) \]
\[ x = \# \text{ (Deaths in a Mission Accident)} \]
\[ y = \# \text{ (Deaths in case of no Mission Accident)} = 0 \]

**Definition:**
\[ \text{RISK} = \text{Expected Number of during the Mission} \]

\[ \text{RISK} = px + (1-p)y = px = \text{Probability} \ast \text{Impact} \]

- **What Uncertainty Is Modeled?**

\[ A = \begin{cases} 
  a_0 & \text{No Accident during the Mission} \\
  a_1 & \text{Accident during the Mission} 
\end{cases} \]

- **Uncertainty Model:**

\[ \Pr(A = a_i) = \begin{cases} 
  1 - p & i = 0 \\
  p & i = 1 
\end{cases} \]

- **Is This Satisfactory?**
Where are Additional Uncertainties located in the Model Above?

**SOURCE 1:** We are uncertain about the probability \( p \rightarrow P \)

**SOURCE 2:** We are uncertain about the consequence \( x \rightarrow X \)

Allows us to express Uncertainty in Output in terms of Credibility Intervals:

e.g. probability that Mission Mortality is between A and B is 95%.
How do we get Input Uncertainty?

\[
\text{INPUT UNCERTAINTY}
\]

\[
\text{ACCIDENT/CONSEQUENCE DATA BASE}
\]

\[
\text{RISK} = \text{P} \times \text{X} + (1 - \text{P}) \times 0
\]

But:
- Accidents under study are typically **rare events**, often resulting in point estimates for probability and consequences with very large uncertainty bands.

**Uncertainty = Statistical Uncertainty**

Because of focus on data-driven risk assessment.
PRACTICAL LIMITATION OF DATA DRIVEN APPROACH FOR UNCERTAINTY

INPUT ASSESSMENT

E\[P\] = Average Probability

\# Movements per year with Accidents
\frac{\text{Total \# of Movements per year}}{}

E[X|\text{Accident Occurs}] = Average \# Deaths

\# Deaths in Accidents
\frac{\text{Total \# of Accidents}}{}

MODEL

E[ RISK ] = E[P]*E[X|\text{Accident}]
+ (1-E[P])*0 = Average Risk

Conclusion:
- Uncertainty is often not analyzed due to limitations in availability of data + resource constraints.
- If uncertainty is analyzed based on data, uncertainty bands are too wide for meaningful interpretation.
HOW CAN WE DO BETTER?

1. INPUT ASSESSMENT
   - E[P] = Average Probability
   - E[X|Accident Occurs] = Average # Deaths

2. Update Uncertainty by Expert Judgment + Bayes Theorem

   | P   | E[X|Accident Occurs] |
   |-----|---------------------|
   | 0.00|                    |
   | 0.20|                    |
   | 0.40|                    |
   | 0.60|                    |
   | 0.80|                    |
   | 1.00|                    |

   | 0.00|                    |
   | 0.20|                    |
   | 0.40|                    |
   | 0.60|                    |
   | 0.80|                    |
   | 1.00|                    |
   | 1.20|                    |
   | 1.40|                    |

RISK = P*X + (1-P)*0 =

Approach above is advocated by Kaplan & Garrick
DILEMMA OF UNCERTAINTY MODELER

Client Always Wants More Detail:

Client prefers to have a very detailed "causal" probability model which explicitly models the effect of situational factors on the accident or consequence probability. E.g. the effect of visibility on the probability of an aircraft accident or the effect of guidance systems like GPS on the...
What to do?
Decompose Model in Smaller Components that may be estimated using Expert Judgment.
**STEP 1: MODELING UNCERTAINTY IN ACCIDENT PROBABILITY**

1. **INPUT ASSESSMENT**
   - \( E[P] = \text{Average Probability} \)
   - Solve for \( P_0 \)

2. **INPUT:** SPARSE DATA + EXPERT JUDGEMENT THROUGH PAIRWISE COMPARISON OF SITUATIONS

3. **OUTPUT:** SLIDING DISTRIBUTION ON ACCIDENT PROBABILITY
   - \( E[P] = P_0 \times \text{Rel. Prob.} \)

4. **OUTPUT UNCERTAINTY**
   - Uncertainty in Frequency of Situational and Organizational Factors

**ACCIDENT/CONSEQUENCE DATA BASE**

**ACCIDENT PROBABILITY MODEL**
- Stage 1: Basic/Root Causes
- Stage 2: Immediate Causes
- Stage 3: Incident
- Stage 4: Accident
**STEP 2:** MODELING UNCERTAINTY IN CONSEQUENCE PROBABILITY GIVEN AN ACCIDENT

**OUTPUT:** SLIDING DISTRIBUTION ON CONSEQUENCE GIVEN AN ACCIDENT PROBABILITY

\[ E[X] = X_0 \times \text{Rel. Prob.} \]

**ACCIDENT/CONSEQUENCE DATA BASE**

**INPUT ASSESSMENT**

\[ E[X] = \text{Average Consequence} \]

Solve for \( X_0 \)

**CONSEQUENCE GIVEN AN ACCIDENT PROBABILITY MODEL**

**Stage 4**

**Accident**

**Stage 5**

**Immediate Consequence**

**INPUT:** SPARSE DATA + EXPERT JUDGEMENT THROUGH PAIRWISE COMPARISON OF SITUATIONS

**OUTPUT UNCERTAINTY**

Uncertainty in Frequency of Situational and Organizational Factors
WHAT IS EXPERT JUDGMENT?

IT IS NOT!
A Group of Experts in
a Room deciding on Numbers.

**EXPERT JUDGEMENT ELICITATION PROCEDURE**

| STRUCTURED APPROACH TO CAPTURING AN EXPERTS KNOWLEDGE BASE AND CONVERT HIS KNOWLEDGE BASE INTO QUANTITATIVE ASSESSMENTS. |
| MODELERS SKILLED IN DECOMPOSITION AND AGGREGATION OF ASSESSMENTS | ELICITATION PROCESS = MULTIPLE CYCLES (AT LEAST 2) |
| | |
| | 1. DECOMPOSITION OF EVENT OF INTEREST TO A MEANINGFULL LEVEL FOR SUBSTANTIVE EXPERT |
| | 2. ELICITATION OF JUDGMENT OF SUBSTANTIVE EXPERT FACILITATED BY NORMATIVE EXPERT |
| | 3. AGGREGATION OF JUDGEMENTS BY NORMATIVE EXPERT |
| EXPERTS | NORMATIVE |
| SUBSTANTIVE |
| KNOWLEDGABLE ABOUT THE SUBJECT MATTER AND EXTENSIVE EXPERIENCE |
EXAMPLE: THE DELPHI METHOD

- Early 1950: Developed by RAND Corporation as spin-off of an Air Force Research Project, "Project Delphi".
- 1963: Wider audience due to 1963 RAND Study "Report on a long-range Forecasting study".

Probably, best known method to date of Eliciting and synthesizing expert judgment.

STEP 1:
Monitoring Team defines set of issues and selects sets of Respondents who are experts on the issues in question. Respondents do not know who other respondents are, and the responses are anonymous. Preliminary questionnaire is sent for comments, which are then used to establish a definitive questionnaire.

STEP 2:
Questionnaire is sent to respondents. Monitoring Team analyses the answers.

STEP 3:
The set of responses is sent back together with 25% lower and 25% upper responses. The respondents are asked if they wish to revise the initial predictions. Those who answered outside of the above range are asked to give arguments.

STEP 4:
The revised predictions are analyzed by the monitoring team and the outliers for arguments are summarized. GOTO STEP 2.

TYPICALLY THREE ROUNDS
EXAMPLE OF DELPHI QUESTIONNAIRE # 1

Questionnaire # 1

This is the first in a series of four questionnaires intended to demonstrate the use of the Delphi Technique in obtaining reasoned opinions from a group of respondents.

Each of the following six questions is concerned with developments in the United States with the next few decades.

In addition to giving your answer to each question, you are also being asked to rank the questions from 1 to 7. Here “1” means that in comparing your ability to answer this question with what you expect the ability of the other participants to be, you feel that you have the relatively best chance of coming closer to the truth than most of the others, while a “7” means that you regard that chance as relative least.

<table>
<thead>
<tr>
<th>Rank</th>
<th>Question</th>
<th>Answer*</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>In your opinion, in what year will the median family income (in 1967 dollars) reach twice its present amount?</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>In what year will the percentage of electric automobiles along all automobile in use reach 50 percent?</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>In what year will the percentage of households that are equipped with computer consoles tied to a central computer and databank reach 50 percent?</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>By what year will the per capita amount of personal cash transactions (in 1967 dollars) be reduced to one-tenth of what it is now?</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>In what year will power generation by thermonuclear fusion become commercially competitive with hydroelectric power?</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>By what year will it be possible by commercial carriers to get from New York’s Time Square to San Francisco’s Union Square in half the time that is now required to make that trip?</td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>In what year will a man for the first time travel to the Moon, stay for at least 1 month, and return to earth?</td>
<td></td>
</tr>
</tbody>
</table>
* "Never" is also an acceptable answer

Please also answer the following question, and give your name (this is for identification purposes during the exercise only; no opinions will be attributed to a particular person).

Check One:  
☐ I would like
☐ I am willing but no anxious
☐ I would prefer not participate in the three remaining questionnaires

Name (block letter please):

Source: Helmer (1968)
CRITIQUE ON DELPHI METHOD:
(Sackman's Delphi Critique (1975))

Methodological

- Questions are vague are often so vague that it would be impossible to determine when, if ever, they occurred.

- Furthermore, the respondents are not treated equally.

- Many dropouts. No Explanation for # of dropouts given or researched, nor are effects assessed on eventual assessment. Does Delphi convergence because of boredom in stead of consensus.

- Sackman argues that experts and non experts produce comparable results.

Comparison to other Methods
(Delbecq, Van de Ven, and Gusstafson, 1975);

- **Method 1**: "nominal group technique"; participants confront each other directly in a controlled environment.

- **Method 2**: "no interaction model”; initial assessments are simply aggregated mathematically.

**Results:**
- Nominal group technique superior to the others,
- Delphi worst of the three.
EXPERT JUDGMENT ELICITATION PRINCIPLES
(Source: Experts in Uncertainty, Roger M. Cooke)

1. Reproducibility:
   It must be possible for Scientific peers to review and if necessary reproduce all calculations. This entails that the calculational model must be fully specified and the ingredient data must be made available.

2. Accountability:
The source of Expert Judgment must be identified.

3. Empirical Control:
   Expert probability assessment must in principle be susceptible to empirical control.

4. Neutrality:
The method for combining/evaluating expert judgements should encourage experts to state true opinions.

5. Fairness:
   All Experts are treated equally, prior to processing the results of observation
PRACTICAL EXPERT JUDGMENT
ELICITATION GUIDELINES

1. The questions must be clear

2. Prepare an attractive format for the questions and graphic format for the answers

3. Perform a dry run

4. An Analyst must be present during the elicitation

5. Prepare a brief explanation of the elicitation format, and of the model for processing the responses.

6. Avoid Coaching

7. The elicitation session should not exceed 1 hour.
ELICITATION PROCEDURES

- **Direct Procedures:** Ask for Probabilities, Measures of Central Tendency, Measures of Variability
- **Indirect Procedures:** Use Betting Strategies, Pairwise Comparisons

Example Betting Strategies: Indifference Expected payoffs are the same

1. **Betting Strategies**

   **Event:** Lakers winning the NBA title this season

   **STEP 1:** Offer a person to choose between following the following bets, where \( X=100, \ Y=0 \).

   ![Betting Strategy Diagram]

   **Max Profit**
   - Lakers Win: \( X \)
   - Lakers Loose: \( -Y \)
   - Bet for Lakers: \( -X \)
   - Bet against Lakers: \( Y \)
STEP 2: Offer a person to choose between following the following bets, where X=0, Y=100. (Consistency Check)

STEP 3: Offer a person to choose between following the following bets, where X=100, Y=50.

STEP 4: Offer a person to choose between following the following bets, where X=50, Y=100. (Consistency Check)

Continue until point of indifference has been reached.

Assumption:

When a person is indifferent between bets the expected payoffs from the bets must be the same.

Thus:

\[ X \cdot \text{Pr}(LW) - Y \cdot \text{Pr}(LL) = -X \cdot \text{Pr}(LW) + Y \cdot \text{Pr}(LL) \iff \]

\[ 2 \cdot X \cdot \text{Pr}(LW) - 2 \cdot Y \cdot (1 - \text{Pr}(LW)) = 0 \iff \]

\[ \text{Pr}(LW) = \frac{Y}{X+Y}. \]

Example: X=100, Y=50 \(
\text{Pr}(LW) = \frac{2}{3} \approx 66.66\% \)
2. Pairwise Comparisons of Situations

Issaquah class ferry on the Bremerton to Seattle route in a crossing situation within 15 minutes, no other vessels around, good visibility, negligible wind.

Other vessel is a navy vessel
Other vessel is a product tanker

<table>
<thead>
<tr>
<th>Question: 1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Situation 1</td>
</tr>
<tr>
<td>Issaquah</td>
</tr>
<tr>
<td>SEA-BRE(A)</td>
</tr>
<tr>
<td>Navy</td>
</tr>
<tr>
<td>Crossing</td>
</tr>
<tr>
<td>0.5 – 5 miles</td>
</tr>
<tr>
<td>No Vessel</td>
</tr>
<tr>
<td>No Vessel</td>
</tr>
<tr>
<td>No Vessel</td>
</tr>
<tr>
<td>&gt; 0.5 Miles</td>
</tr>
<tr>
<td>Along Ferry</td>
</tr>
<tr>
<td>0</td>
</tr>
</tbody>
</table>

Likelihood of Collision Avoidance

<table>
<thead>
<tr>
<th>9</th>
<th>8</th>
<th>7</th>
<th>6</th>
<th>5</th>
<th>4</th>
<th>3</th>
<th>2</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>8</th>
<th>9</th>
</tr>
</thead>
<tbody>
<tr>
<td>Situation 1 is worse</td>
<td>&lt;====================X====================&gt; Situation 2 is worse</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
</tr>
</tbody>
</table>

9: VERY MUCH MORE LIKELY to result in a collision.
7: MUCH MORE LIKELY to result in a collision.
5: MODERATELY LIKELY to result in a collision.
3: SOMEWHAT MORE LIKELY to result in a collision.
1: EQUALY LIKELY to result in a collision.
Underlying Model for Pairwise Comparison Questionnaire

1. Traffic Scenario 1 = $X^1$ \(\xleftarrow{\text{Paired Comparison}}\) Traffic Scenario 2 = $X^2$

\[
Y(X) = \text{Vector including 2-way interactions}
\]

2. \[
\Pr(\text{Accident} \mid \text{Propulsion Failure, } X^1) = P_0 e^{\beta^T Y(X^1)}
\]

3. \[
\frac{\Pr(\text{Accident} \mid \text{Prop. Failure, } X^1)}{\Pr(\text{Accident} \mid \text{Prop. Failure, } X^2)} = \frac{P_0 e^{\beta^T Y(X^1)}}{P_0 e^{\beta^T Y(X^2)}} = e^{\beta^T (Y(X^1) - Y(X^2))}
\]

4. \[
\text{LN} \left\{ \frac{\Pr(\text{Accident} \mid \text{Prop. Failure, } X^1)}{\Pr(\text{Accident} \mid \text{Prop. Failure, } X^2)} \right\} = \beta^T \left( Y(X^1) - Y(X^2) \right)
\]

Calibration to Accident Data

1. Calibrating the constructed scale on which experts responded e.g. fix the ratio of collisions of Washington State Ferries with Washington State Ferries and NON-WSF Vessels.

2. Calibrating to convert relative probabilities to absolute probabilities by solving for $P_0$ e.g. fix the total number of expected collisions over a given time period.
3. Pairwise Comparisons of Attributes

- Some variables do not have a natural attributes scale e.g. the combination of ferry class & ferry routes = (High Speed Ferry on the Seatle Bremerton Run, Super Class Ferry on the Seattle Bainbridge run).

<table>
<thead>
<tr>
<th>26 Combinations of Ferry Class &amp; Ferry Route</th>
</tr>
</thead>
<tbody>
<tr>
<td>⇒ 325 Paired Comparisons</td>
</tr>
<tr>
<td>Too Many Questions</td>
</tr>
</tbody>
</table>

Solution

- Compare Ferry Classes ⇒ R(Ferry Class)
- Compare Ferry Routes ⇒ R(Ferry Route)
- Ask relative importance W of Ferry Class to Ferry Route

$$\text{Rank} = W \times R(\text{Ferry Class}) + (1-W) \times R(\text{Ferry Route})$$

Question Format

<table>
<thead>
<tr>
<th>9 Ferry Classes ⇒ 36 Paired Comparisons</th>
</tr>
</thead>
</table>

If you think collision avoidance is equally likely for Issaquah as for Jumbo Mark II you answer:

| Issaquah | <-- | = | --> | Jumbo Mark II | ? |

If you think collision avoidance is more likely for Issaquah as for Jumbo Mark II you answer:

| Issaquah | <-- | x | = | --> | Jumbo Mark II | ? |

If you cannot answer the question, you answer:

| Issaquah | <-- | = | --> | Jumbo Mark II | ? | x |
Perform Bradley Terry Pairwise Comparison Analysis to:
1. Test for Preference Structure of individual expert by counting circular triads.

Circular Triad: A is better than B, B is better than C, C is better than A.

2. Test for Agreement between experts as a group.

Results Attribute Scale for Ferry Class
Results Attribute Scale for Ferry Route

Using Swing Weights Elicitation Method (EMGT 269)
Ferry Class Weight = 0.42
Ferry Route Weight = 0.59
Results Attribute Scale for 
Ferry Class & Ferry Route Combination
Laws of Probability

\[ A = \text{an event with possible outcomes} \ A_1, \cdots, A_n; \]
\[ \Omega = \text{Total Event} \]

Venn Diagrams:

Ratio of area of the event and the area of the total rectangle can be interpreted as the probability of the event.

- Probabilities must lie between 0 and 1:
  \[ 0 \leq \Pr(A_1) \leq 1, \forall A_1 \subset \Omega \]

- Probabilities must add up:
  \[ A_1 \cap A_2 = \emptyset \Rightarrow \Pr(A_1 \cup A_2) = \Pr(A_1) + \Pr(A_2) \]
• Total Probability Must Equal 1:
\[ (A_i \cap A_j = \emptyset, \forall i \neq j \land \bigcup_{i=1}^{3} A_i = \Omega) \implies \Pr(\bigcup_{i=1}^{3} A_i) = 1 \]

\[ \begin{array}{c|c|c}
A_1 & A_2 & A_3 \\
\hline
\end{array} \quad \Omega \]

• Complement Rule:
\[ \Pr(\overline{A_1}) = 1 - \Pr(A_1) \]

\[ \begin{array}{c}
A_1 \\
\hline
\overline{A_1} \quad \Omega \end{array} \]

• Probability of union of two events that can happen at the same time
\[ \Pr(A_1 \cup A_2) = \Pr(A_1) + \Pr(A_2) - \Pr(A_1 \cap A_2) \]

\[ \begin{array}{c}
A_1 \\
\hline
A_2 \quad \Omega \end{array} \]
Conditional Probability:

\[
\text{Pr} (\text{Car Accident} \mid \text{Bad Weather}) = \frac{\text{Pr}(\text{Car Accident} \cap \text{Bad Weather})}{\text{Pr} (\text{Bad Weather})}
\]

Informally: Conditioning on an event coincides with reducing the total event to the conditioning event

- Multiplicative Rule:

\[
\text{Pr}(A_1 \cap B_1) = \text{Pr}(B_1 \mid A_1) \times \text{Pr}(A_1) = \text{Pr}(A_1 \mid B_1) \times \text{Pr}(B_1)
\]
Law of Total Probability:

\[ B_1, \ldots, B_3 \text{ mutually exclusive, collectively exhaustive:} \]

\[ \Pr(A_1) = \Pr(A_1 \cap B_1) + \Pr(A_1 \cap B_2) + \Pr(A_1 \cap B_3) \iff \]

\[ \Pr(A_1) = \Pr(A_1 | B_1) \Pr(B_1) + \Pr(A_1 | B_2) \Pr(B_2) + \Pr(A_1 | B_3) \Pr(B_3) \]

Example Law of Total Probability:

\[ \Pr(\text{Hospital}) = \]
\[ \Pr(\text{Hospital} | \text{Car Accident}) \Pr(\text{Car Accident}) + \]
\[ \Pr(\text{Hospital} | \text{No Car Accident}) \Pr(\text{No Car Accident}) \]

- Also Referred To As LOEC:

  Law Of Extension of Conversation
Bayes Theorem

\( B_1, \ldots, B_3 \) mutually exclusive, collectively exhaustive:

\[
\begin{align*}
1. & \Pr(A_1 \cap B_j) = \Pr(B_j | A_1) \Pr(A_1) = \Pr(A_1 | B_j) \Pr(B_j) \\
2. & \Pr(B_j | A_1) = \frac{\Pr(A_1 | B_j) \Pr(B_j)}{\Pr(A_1)} \\
3. & \Pr(A_1) = \Pr(A_1 | B_1) \Pr(B_1) + \Pr(A_1 | B_2) \Pr(B_2) + \Pr(A_1 | B_3) \Pr(B_3) \\
4. & \Pr(B_j | A_1) = \frac{\Pr(A_1 | B_j) \Pr(B_j)}{\Pr(A_1 | B_1) \Pr(B_1) + \Pr(A_1 | B_2) \Pr(B_2) + \Pr(A_1 | B_3) \Pr(B_3)}
\end{align*}
\]
Example: Game Show
Suppose we have a game show host and you. There are three doors and one of them contains a prize. The game show host knows the door containing the prize but of course does not convey this information to you. He asks you to pick a door. You picked door 1 and are walking up to door 1 to open it when the game show host screams: STOP. You stop and the game show host shows door 3 which appears to be empty. Next, the game show asks.

"DO YOU WANT TO SWITCH TO DOOR 2?"
WHAT SHOULD YOU DO?

Assumption 1: The game show host will never show the door with the prize.
Assumption 2: The game show will never show the door that you picked.

\[ D_i = \{ \text{Prize is behind door } i \}, \quad i = 1, \ldots, 3 \]
\[ H_i = \{ \text{Host shows door } i \text{ containing no prize after you selected Door 1} \}, \quad i = 1, \ldots, 3 \]

Initially: \( \Pr(D_1) = \frac{1}{3} \)

1. \( \Pr(H_3) = \sum_{i=1}^{3} \Pr(H_3 \mid D_i) \Pr(D_i) = \frac{1}{2} \times \frac{1}{3} + \frac{1}{3} + 0 \times \frac{1}{3} = \frac{1}{2} \)

2. \( \Pr(D_1 \mid H_3) = \frac{\Pr(H_3 \mid D_1) \Pr(D_1)}{\Pr(H_3)} = \frac{\frac{1}{2} \times \frac{1}{3}}{\frac{1}{2}} = \frac{1}{3} \)

3. \( \Pr(D_2 \mid H_3) = 1 - \Pr(D_1 \mid H_3) = 1 - \frac{1}{3} = \frac{2}{3} \cdot \)

So Yes, you should switch!
RANDOM VARIABLES

Mathematical tool to shorten description of a complex real event.

Discrete Random Variable:

X = # of Car Accidents on Inner loop of the Capital Beltway, X=0,1,2,3,...
Continuous Random Variable:

\(X= \) Failure Time of a Pressure Relief Valve under continuous pressure, \(X \in [0, \infty)\)

Exponential Life Time Distribution:

Weibull Life Time Distribution:

Failure Rate = \(\Pr(t < T < t + \Delta t \mid T > t) = \frac{\Pr(t < T < t + \Delta t)}{\Pr(T > t)}\)
**MEASURES OF CENTRAL TENDENCY**

SKEWED TO LEFT  :  Mode < Mean < Median  
SKEWED TO RIGHT :  Mode > Mean > Median  
SYMMETRIC       :  ?
DOMINANCE AND MAKING DECISIONS UNDER UNCERTAINTY

Suppose you have to choose between two lottery tickets and the only information you have is that the expected pay-off of the first lottery ticket is lower than the second. Which one would you choose?

You picked your ticket and the lotteries are played and you learn your outcome. Is your pay-off higher than the pay-off of the first lottery-ticket?

**Conclusion:** There is a chance of an *unlucky outcome*. In other words there is no dominance (=deterministic dominance).

---

**MAKING DECISIONS & RISK LEVEL**

- **Deterministic Dominance Present**
  - **Stochastic Dominance Present**
    - **Choose Alternative with Best EMV**

**Diagram Notes:**
- Chances of unlucky outcome increases.
SITUATION 1:
You are given more information about both lotteries. The pay-off $X$ of lottery 1 falls in the range from $[A,B]$. The pay-off from lottery 2 falls in the range from $[C,D]$.

Assume random Variable $X$ Uniformly Distributed on $[A,B]$  
Assume random Variable $Y$ Uniformly Distributed on $[C,D]$

Which one would you choose?

You picked your ticket and the lotteries are played and you learn your outcome. Is your pay-off higher than the pay-off of the first lottery-ticket?

**Conclusion:** There is a no chance of an **unlucky outcome**. In other words there is dominance (=deterministic dominance).
SITUATION 2:
You are given more information about both lotteries. The pay-off X of lottery 1 falls in the range from [A,B]. The pay-off from lottery 2 falls in the range from [C,D].

Assume random Variable X Uniformly Distributed on [A,B]
Assume random Variable Y Uniformly Distributed on [C,D]

Note:
Pr(Y<z) < Pr(X< z)
for all z

You picked your ticket and the lotteries are played and you learn your outcome. Is your pay-off higher than the pay-off of the first lottery-ticket?

Conclusion: There is a a chance of an unlucky outcome. In this case there is stochastic dominance, but no deterministic dominance.
**SITUATION 3:**
You are given more information about both lotteries. The pay-off $X$ of lottery 1 falls in the range from $[A,B]$. The pay-off from lottery 2 falls in the range from $[C,D]$.

You picked your ticket and the lotteries are played and you learn your outcome. Is your pay-off higher than the pay-off of the first lottery ticket?
UNCERTAINTY ANALYSIS VERSUS SENSITIVITY ANALYSIS

Uncertainty Analysis = Quantification of Output Uncertainty given Model and Input Uncertainty

Sensitivity Analysis = Sensitivity of Output Parameter to change in one parameter keeping others constant.
MONTE CARLO SIMULATION

INPUT UNCERTAINTY

Sample $X_1, Y_1, Z_1$ → Calculate $O_1$
Sample $X_2, Y_2, Z_2$ → Calculate $O_2$
Sample $X_3, Y_3, Z_3$ → Calculate $O_3$

ETC ...

MODEL = $F(X, Y, Z)$

OUTPUT

STATISTICS

Lecture Notes by: Dr. J. Rene van Dorp
REGRESSION ANALYSIS

MODEL:
\[ O = a_1(X) + a_2G(Y) + a_3H(Z) \]

Assumption 1: Normality Assumption

Assumption 2: Linearity Assumption

Independent Variables

Data on X

Data on Y

DATA on Z

INPUT UNCERTAINTY

F(X)

G(Y)

H(Z)

OUTPUT

O