CS 1571 Introduction to AI
Lecture 22

Decision making in the presence of uncertainty

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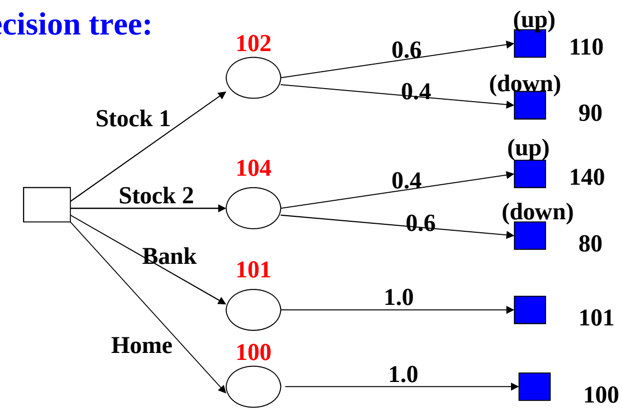
Decision-making in the presence of uncertainty

- Many real-world problems require **to choose future actions in the presence of uncertainty**
- **Examples:** patient management, investments

Main issues:
- **How to model the decision process in the computer ?**
- **How to make decisions about actions in the presence of uncertainty?**

(Stochastic) Decision tree

- **Decision tree:**



- **decision node**
- **chance node**
- **outcome (value) node**

Sequential (multi-step) problems

The decision tree can be build to capture multi-step decision problems:

- Choose an action
- Observe a stochastic outcome
- And repeat

How to make decisions for multi-step problems?

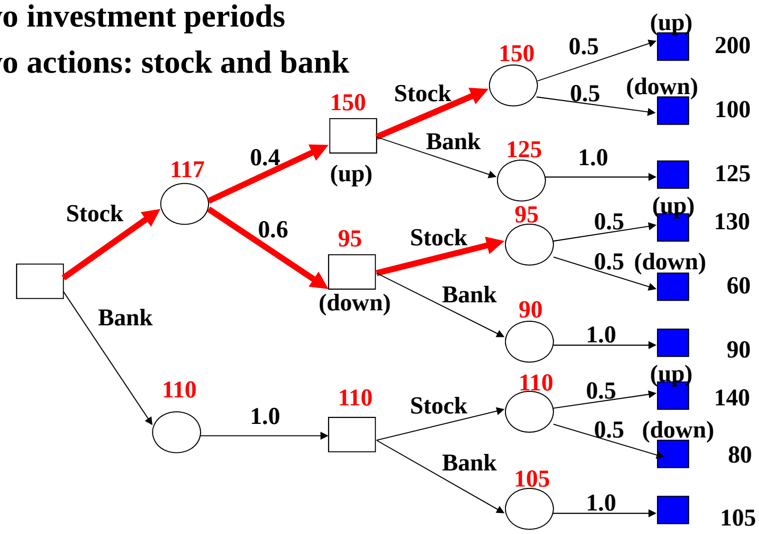
- Start from the leaves of the decision tree (outcome nodes)
- Compute expectations at chance nodes
- Maximize at the decision nodes

Algorithm is sometimes called **expectimax**

Multi-step problem example

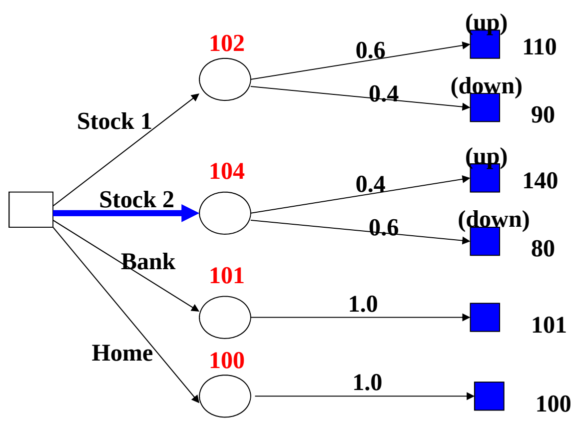
Assume:

- **Two investment periods**
- **Two actions: stock and bank**



Selection based on expected values

- **Until now:** The optimal action choice was the option that maximized the expected monetary value.
- **But is the expected monetary value always the quantity we want to optimize?**



Selection based on expected values

- **Is the expected monetary value always the quantity we want to optimize?**
- **Answer:** Yes, but only if we are risk-neutral.

- But what if **we do not like the risk (we are risk-averse)?**
- In that case we may want to get the premium for undertaking the risk (of loosing the money)
- **Example:**
  - we may prefer to get \$101 for sure against \$102 in expectation but with the risk of loosing the money
- **Problem:** How to model decisions and account for the risk?
- **Solution:** use **utility function, and utility theory**

Utility function

- **Utility function (denoted U)**
  - Quantifies how we "value" outcomes, i.e., it reflects our preferences
  - Can be also applied to "value" outcomes other than money and gains (e.g. utility of a patient being healthy, or ill)
- **Decision making:**
  - uses expected utilities (denoted EU)

$$EU(X) = \sum_{x \in \Omega_X} P(X = x) U(X = x)$$

$U(X = x)$ the utility of outcome x

Important !!!

- Under some conditions on preferences **we can always design the utility function that fits our preferences**

Utility theory

- **Defines axioms on preferences** that involve uncertainty and ways to manipulate them.
- Uncertainty is modeled through **lotteries**
  - **Lottery:**

    $$[p : A; (1-p) : C]$$

    - Outcome A with probability p
    - Outcome C with probability (1-p)
- The following six constraints are known as the axioms of utility theory. The axioms are the most obvious semantic constraints on preferences with lotteries.
- **Notation:**

  $\succ$ - preferable

  $\sim$ - indifferent (equally preferable)

Axioms of the utility theory

- **Orderability:** Given any two states, a rational agent prefers one of them, else the two as equally preferable.

  $$(A \succ B) \vee (B \succ A) \vee (A \sim B)$$

- **Transitivity:** Given any three states, if an agent prefers *A* to *B* and prefers *B* to C, the agent must prefer *A* to C.

  $$(A \succ B) \wedge (B \succ C) \Rightarrow (A \succ C)$$

- **Continuity:** If some state *B* is between *A* and C in preference, then there is a *p* for which the rational agent will be indifferent between state B and the lottery in which A comes with probability p, C with probability (1-p).

  $$(A \succ B \succ C) \Rightarrow \exists p \, [p : A; (1-p) : C] \sim B$$

Axioms of the utility theory

- **Substitutability:** If an agent is indifferent between two lotteries, *A* and *B*, then there is a more complex lottery in which A can be substituted with B.

$$(A \sim B) \Rightarrow [p : A; (1-p) : C] \sim [p : B; (1-p) : C]$$

- **Monotonicity:** If an agent prefers *A* to *B*, then the agent must prefer the lottery in which A occurs with a higher probability

$$(A \succ B) \Rightarrow (p > q \Leftrightarrow [p : A; (1-p) : B] \succ [q : A; (1-q) : B])$$

- **Decomposability:** Compound lotteries can be reduced to simpler lotteries using the laws of probability.

$$[p : A; (1-p) : [q : B; (1-q) : C]] \Rightarrow$$
$$[p : A; (1-p)q : B; (1-p)(1-q) : C]$$

Utility theory

If the agent obeys the axioms of the utility theory, then

1. there exists a real valued function U such that:

$$U(A) > U(B) \Leftrightarrow A \succ B$$
$$U(A) = U(B) \Leftrightarrow A \sim B$$

2. The utility of the lottery is the expected utility, that is the sum of utilities of outcomes weighted by their probability

$$U[p : A; (1-p) : B] = pU(A) + (1-p)U(B)$$

3. Rational agent makes the decisions in the presence of uncertainty by maximizing its expected utility

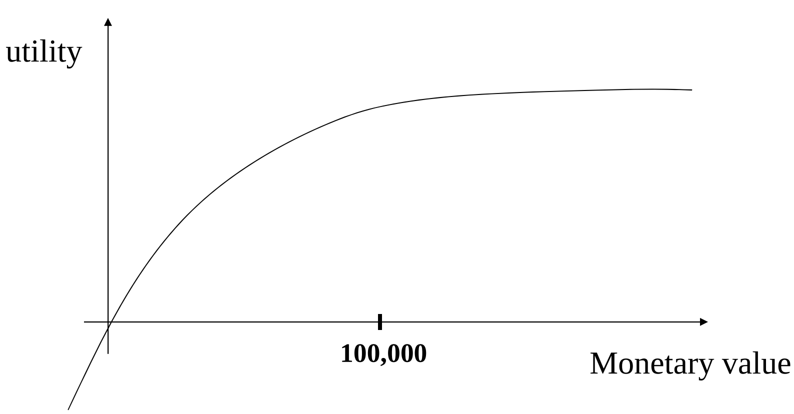
Utility functions

We can design a utility function that fits our preferences if they satisfy the axioms of utility theory.

- **But how to design the utility function for monetary values so that they incorporate the risk?**
- **What is the relation between utility function and monetary values?**
- Assume we loose or gain $1000.
  - Typically this difference is more significant for lower values (around $100 -1000) than for higher values (~ $1,000,000)
- What is the relation between utilities and monetary value for a typical person?

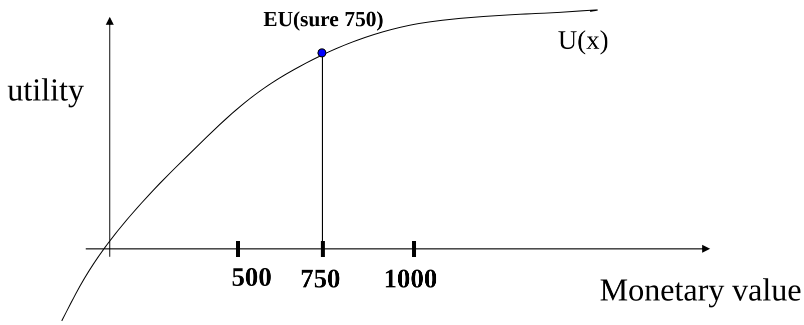
Utility functions

- What is the relation between utilities and monetary value for a typical person?
- **Concave function** that flattens at higher monetary values



Utility functions

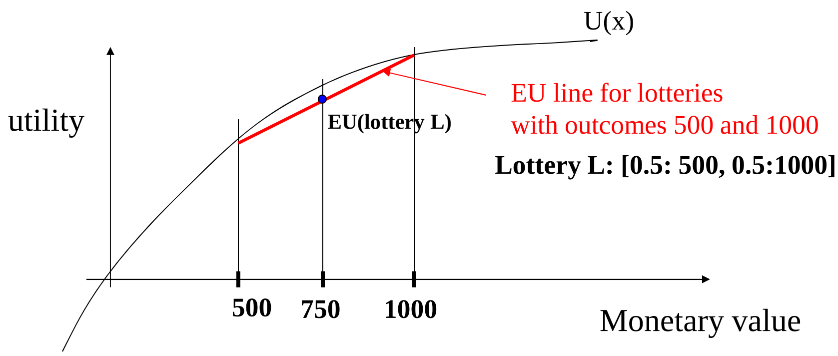
- Expected utility of a sure outcome of 750



Utility functions

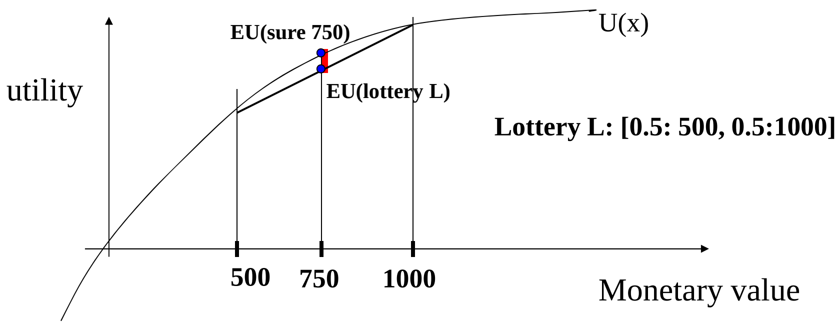
Assume a lottery L [0.5: 500, 0.5:1000]

- Expected value of the lottery = 750
- Expected utility of the lottery EU(L) is different:
  - EU(L) = 0.5U(500) + 0.5*U(1000)



Utility functions

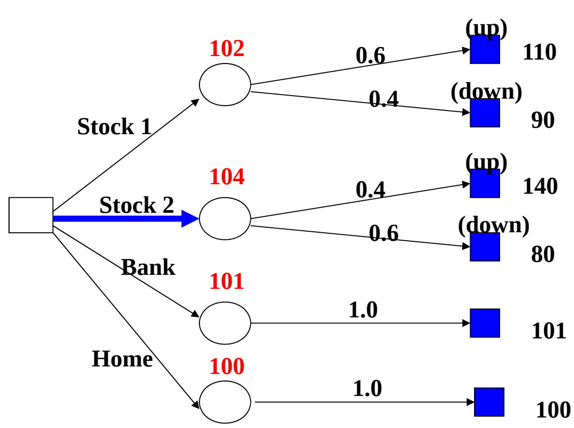
- Expected utility of the lottery EU(lottery L) < EU(sure 750)



- **Risk aversion** – a bonus is required for undertaking the risk

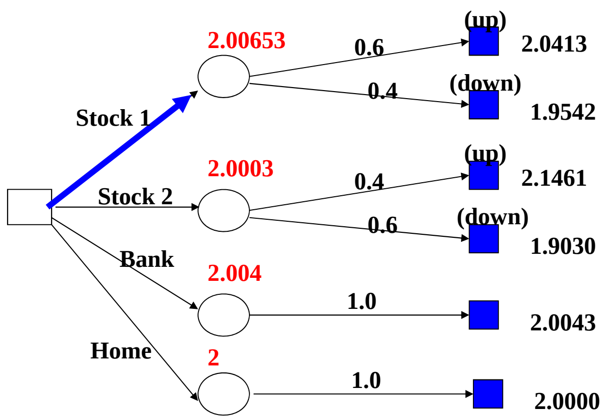
Decision making with utility function

- **Original problem with monetary outcomes**



Decision making with the utility function

- **Utility function log (x)**



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