'MATH+ECON+CODE' MASTERCLASS ON MATCHING MODELS, OPTIMAL TRANSPORT AND APPLICATIONS

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Block 9. Quantile methods

Learning objectives: block 9

- Univariate quantiles: properties and uses; quantile regression
- Rosenblatt's quantiles
- Vector quantiles; vector quantile regression

References for block 9

- [OTME], Ch. 6.3 and 9.5
- Hedonic models: Ekeland, Heckman and Nesheim, Heckman, Nesheim and Matzkin
- Quantile regression: Koenker and Bassett (1978), Koenker (2005)
- Vector quantiles: Ekeland, G and Henry (2012), Carlier, G and Santambrogio (2010), Carlier, G. and Chernozhukov (2016) Chernozhukov, G, Hallin and Henry (2016)

- In dimension one, there are several equivalent ways to define a quantile map $Q_Y : [0,1] \to \mathbb{R}$, among which:
  - the inverse of a cdf: $Q_Y(t) = F_Y^{-1}(t) = \inf\{y : F_Y(y) > t\}$;
  - the minimizer of $\mathbb{E}[\rho_t(Y-q)]$ with $\rho_t(w) = tw^+ + (1-t)w^-$;
  - the map T that maximizes $\mathbb{E}[UT(U)]$ subject to $T\#\mathcal{U}([0,1]) = P$.
- While equivalent in dimension one, the first two definitions cannot be generalized to the case when Y is multivariate, while the last one can, thanks to Brenier's theorem.
- The *vector quantile* associated with definition P is the (unique) gradient of a convex function $Q = \nabla\varphi$ such that if $U \sim \mu = \mathcal{U}\left([0,1]^d\right)$, then $\nabla\varphi(U) \sim P$.

- Let P be a continuous distributions over $\mathbb{R}^2$ with finite second moments, and let $\mu = \mathcal{U}\left([0,1]^2\right)$. The *Rosenblatt quantile* of distribution P is defined by

$$\bar{T}(u_1, x_2) = \left(\bar{T}_1(u_1), \bar{T}_2(u_1, u_2)\right)$$

where $\bar{T}$ is given by

$$\bar{T}_1(u_1, u_2) = F_{Y_1}^{-1}(u_1)\text{, and}$$
$$\bar{T}_2(u_1, u_2) = F_{Y_2|Y_1}^{-1}\left(u_2 | Y_1 = F_{Y_1}^{-1}(u_1)\right)$$

- The fundamental property of this map is that $\bar{T}\#\mu = P$, and the Jacobian $D\bar{T}$ is lower triangular. The construction extends: the Rosenblatt quantile is the map $\bar{T}$ such that $T\#\mu = P$, and such that

$$\begin{cases} Y_1 = T_1(U_1) \\ Y_2 = T_2(U_1, U_2) \\ ... \\ Y_M = T_M(U_1, U_2, ..., U_M) \end{cases},$$

has $Y \sim P$ where $U \sim \mu = U([0,1]^d)$, and $T_i(u)$ depends only on $u_1,...,u_i$ and is a nondecreasing function of u_i.

- For $\lambda > 0$, let $T^{\lambda}(u)$ be the optimal transport map between μ and P relative to surplus $\Phi^{\lambda}(u, y) = u_1 y_1 + \lambda u_2 y_2$. One has

$$\bar{T}(u) = \lim_{\lambda \to 0^+} T^{\lambda}(u).$$

- Intuition: because $\lambda \to 0$, the solution will tend to maximize $\mathbb{E}[U_1 Y_1]$ which yields $Y_1 = F_{Y_1}^{-1}(U_1)$, and over set of couplings (U, Y) that verify this relation, will pick those maximizing $\mathbb{E}[U_2 Y_2]$. Thus the $Y_2 = F_{Y_2|Y_1}^{-1}\left(u_2 | F_{Y_1}^{-1}(u_1)\right)$.
- See a rigorous proof in https://arxiv.org/abs/0810.4153.

- Hedonic model: A producer of observed characteristics $z \in \mathbb{R}^k$ and latent characteristics $u \in \mathbb{R}$ must choose to produce a good whose quality is a scalar $y \in \mathbb{R}$.
- The price of a unit of quality y is $p(y)$ (observed) and the cost is $C(z, y)$ (unobserrved) so that the profit of choosing quality y is given by
$$p(y) - C(z, y) + uy = -\psi(z, y) + uy$$
where $\psi(z, y) = C(z, y) - p(y)$ is the observed part of minus the profit, which is assumed to be convex in y, and uy is a technology shock (high u's produce high quality at less cost).
- The indirect utility is given by
$$\varphi(z, u) = \max_y \{-\psi(z, y) + uy\}$$
so by first order conditions, $\partial S(z, y) / \partial y + u = 0$, thus, letting $\psi(z, y) = -S(z, y)$, quality y is chosen by consumer $(z, u(z, y))$ such that
$$u(z, y) := \frac{\partial \psi(z, y)}{\partial y}$$
which is nondecreasing in y.

- The econometrician:
  - assumes U is independent from Z and postulates the distribution μ of U (say, $\mathcal{U}([0,1])$)
  - observes the distribution of choices Y given observable characteristics $Z=z$.
- Then (Matzkin), by monotonicity of $y(z,u)$ in u, one has

$$\frac{\partial \psi(z,y)}{\partial y}=F_{Y|Z}(y|z)$$

which identifies $\partial_y \psi$, and hence the marginal cost $\partial_y C(z,y)$.

- By the same token,

$$\frac{\partial \varphi(z,u)}{\partial u}=F_{Y|Z}^{-1}(u|z)$$

identifies $\partial_u \varphi(z,u)$ to $F_{Y|Z}^{-1}$.

- However, the conditional cdf $F_{Y|Z}(y|z)$ or the conditional quantile $F_{Y|Z}^{-1}(u|z)$ are not very easy to estimate nonparametrically. Indeed, the observations are given under the form (Z_i, Y_i) and if Z is continuous, there is not two units i and i' such that $Z_i = Z_{i'}$.
- Quantile regression therefore adopts a parameterization of the conditional quantile which is linear in Z. That is

$$Q_{Y|Z}(u|z) = z^{\intercal}\beta_u$$

  (note that one can always augment z with nonlinear functions of z, so this parameterization is quite general).
- Note that this amounts to taking a linear parameterization of the indirect utility

$$\varphi(z, u) = z^{\intercal} b_u \text{ with } b_u = \int_0^u \beta_t dt.$$

- In order to estimate β_u, first note that

$$Q_{Y|Z}\left(u|z\right) = \arg\min_{q} \mathbb{E}\left[\rho_u\left(Y-q\right)|Z=z\right]$$

where $\rho_u\left(w\right) = tw^{+} + \left(1-t\right)w^{-}$.

- Therefore, if the conditional quantile has the specified form, β_u is the solution to

$$\min_{\beta\in\mathbb{R}^k} \mathbb{E}\left[\rho_u\left(Y-Z^{\intercal}\beta\right)|Z=z\right]$$

for each z, and therefore it is the solution to the quantile regression problem introduced by Koenker and Bassett (1978)

$$\min_{\beta\in\mathbb{R}^k} \mathbb{E}\left[\rho_u\left(Y-Z^{\intercal}\beta\right)\right].$$

- Koenker and Bassett showed that this problem has a linear programming formulation. Indeed, consider its sample version

$$\min_{\beta\in\mathbb{R}^k}\sum_{i=1}^{n}\rho_u\left(Y_i-Z_i^\intercal\beta\right)$$

- Introducing $Y_i - Z_i^\intercal\beta = P_i - N_i$ with $P_i, N_i \geq 0$, we have

$$\begin{aligned}\min_{\substack{\beta\in\mathbb{R}^k\\ P_i\geq 0, N_i\geq 0}} &\sum_{i=1}^{n} uP_i + (1-u)\,N_i\\ s.t.\ &P_i - N_i = Y_i - Z_i^\intercal\beta\end{aligned}$$

therefore β can be obtained by simple linear programming.

- Now assume quality is a vector $y \in \mathbb{R}^d$, and latent characteristics is $u \in \mathbb{R}^d$ (say, size+amenities). Assume utility of consumer choosing y is given by
$$-\psi(z,y) + u'y$$
where $\psi(z,y) = C(z,y) - P(y)$ is still assumed to be convex in y.
- By first order conditions, quality y is chosen by consumer $(z, u(z,y))$ such that
$$u(z,y) := \nabla_y \psi(z,y)$$
which, conditional on z, is "vector nondecreasing" in y in a generalized sense, where vector nondecreasing=gradient of a convex function.
- As before, assume:
  - The distribution of U given $Z = z$ is μ (say $\mathcal{U}\left([0,1]^d\right)$)
  - The distribution $F_{Y|Z}$ of Y given Z is observed.

- By Brenier's theorem, for each z, $\psi(z,y)$ and $\varphi(z,u)$ are solution to

$$\min_{\psi,\varphi} \mathbb{E}\left[\psi(Z,Y)\right] + \mathbb{E}\left[\varphi(Z,U)\right]$$
$$s.t.\ \psi(z,y) + \varphi(z,u) \geq y^\intercal u$$

- The solution potential $\psi(z,y)$ is convex in y and is such that for $(Z,Y) \sim F_{ZY}$,

$$U = \nabla_y \psi(Z,Y) \sim \mu \text{ and is independent from } Z,$$

or equivalently, for $U \sim \mu$ independent from Z, one has

$$(Z, Y = \nabla_u \varphi(Z,U)) \sim F_{ZY}.$$

- This is the "mass transportation approach" (MTA) to identification, applied to a number of contexts by G and Salanié (2012), Chiong, G, and Shum (2014), Bonnet, G, and Shum (2015), Chernozhukov, G, Henry and Pass (2015).

- In vector quantile regression, one would like to get a more parametric way to write down the dependence of Y in Z; more precisely, linear in Z as in classical quantile regression.
- One way to do this is to set $\varphi(Z, U) = Z^\intercal b(U)$. The M-K problem becomes

$$\min_{\psi,\varphi} \mathbb{E}[\psi(Z, Y)] + \mathbb{E}[Z^\intercal b(U)]$$
$$s.t.\ \psi(z, y) + z^\intercal b(u) \geq y^\intercal u$$

whose primal is

$$\max_{U,Z,Y} \mathbb{E}[U^\intercal Y]$$
$$s.t.\ U \sim \mu$$
$$(Z, Y) \sim F_{ZY}$$
$$\mathbb{E}[Z|U] = \mathbb{E}[Z]$$

Section 1

Coding

- Following Koenker, we use Engel's dataset. The package 'quantreg' performs classical quantile regression.
- For vector quantile regression, we solve the problem using

```
A1 = kronecker(sparseMatrix(1:n,1:n),matrix(1,1,m))
A2 = kronecker(t(X),sparseMatrix(1:m,1:m))
f1 = matrix(t(nu),nrow=n)
f2 = matrix(mu %*% xbar,nrow=m*r)
e = matrix(1,m*n,1)
A = rbind2(A1,A2)
f = rbind2(f1,f2)
result = gurobi
(list(A=A,obj=c,modelsense="min",rhs=f,ub=e,sense="="),
params=NULL )
```