

# Some aspects of random utility, extreme value theory and multinomial logit models

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## Abstract

In this paper we give a survey on some basic ideas related to random utility, extreme value theory and multinomial logit models. These ideas are well known within the field of spatial economics, but do not appear to be common knowledge to researchers in probability theory. The purpose of the paper is to try to bridge this gap.

Keywords: Random utility theory, extreme value theory, multinomial logit models, entropy.

## 1 Introduction

Statisticians and probabilists are in general familiar with models of discrete dependent variables. The multinomial logit model, see, e.g., McFadden (1972), as an example, captures how a discrete dependent variable is affected by a number of covariates. In many applications of such models, the aim is to model the mechanism behind how individuals are choosing among a finite number of alternatives. One example is in which city a person chooses to settle down and what factors are affecting this choice (McFadden et al., 1978). Introductions to the field of discrete choice models can be found in Dagsvik (2000) and Ben-Akiva and Lerman (1993). The latter of those focuses in particular on how the theory is applied to travel demand.

What many statisticians and probabilists are not so familiar with is that such models are naturally arising from random utility theory which is a common way for economists to analyze the economics of discrete choice, see, e.g. Manski (1977). With some behavioural assumptions

on how choices are made, a multinomial logit model arises which can then be fitted to observed data. Compared to many other fields in economics there is thus an unusually direct and mathematically stringent link between the economic theory and the statistical model used to operationalize it.

In this paper we review how this occurs. Furthermore, and perhaps more interestingly, we discuss whether the behavioural assumptions are modest or restrictive. The assumption, very often made, that random utility is Gumbel distributed is at first sight seemingly made purely to make the transition from the economic theory to the statistical model mathematically convenient. It can, however, be shown that there is considerably more depth to this transition and that the assumption of Gumbel distributed random utility is not as restrictive as it might first appear. It can nevertheless also be shown that the generality is limited to distributions with a particular tail behaviour. Since the choices are made based on maximizing random utility we consider this from the perspective of extreme value theory, see, e.g., De Haan and Ferreira (2006).

The sequel of the paper is structured as follows. Section 2 presents the principle of random utility maximization and how it leads to the multinomial logit model. Furthermore, it discusses how and in what circumstances breaches of the assumption of Gumbel distributed random utility is irrelevant for the results. In Section 3, other arguments, in addition to random utility theory, also leading to the multinomial logit model, are reviewed. A real world application with shipping data, originally presented in Ubøe et al. (2009), is revisited in Section 4 and it is argued that a model that corresponds to a Gumbel distributed random utility is empirically plausible. Some concluding remarks closes the paper.

## 2 Random utility maximization

Consider a discrete set  $\mathbf{S} = \{S_1, \dots, S_n\}$  of objects which we will call the choice set. A large number of independent agents want to choose an object each from  $\mathbf{S}$ . Each object  $S_i$  has a deterministic utility  $v_i$  which is common for all agents. In addition each object has a random utility  $\varepsilon_i$ . The  $\varepsilon_i$ -s are IID random variables drawn from a distribution which is common for all objects and all agents. Each agent computes

$$U_i = v_i + \varepsilon_i \quad i = 1, \dots, n \quad (1)$$

and chooses the object with the largest total utility. The basic problem in random utility theory is to compute the probabilities

$$p_i = P(\text{An agent chooses object nr } i) \quad (2)$$

If we assume that  $\varepsilon_i$  has a continuous distribution and use independence, these probabilities can be computed as follows:

$$\begin{aligned} p_i &= P(\text{An agent chooses object nr } i) = P(U_j \leq U_i, \forall j \neq i) \\ &= P(\varepsilon_1 \leq v_i - v_1 + \varepsilon_i, \dots, \varepsilon_{i-1} \leq v_i - v_{i-1} + \varepsilon_i, \varepsilon_{i+1} \leq v_i - v_{i+1} + \varepsilon_i, \\ &\quad \dots, \varepsilon_n \leq v_i - v_n + \varepsilon_i) \\ &= \int_{-\infty}^{\infty} \prod_{\substack{j=1 \\ j \neq i}}^n P(\varepsilon_j \leq v_i - v_j + x) f_\varepsilon(x) dx \end{aligned} \quad (3)$$

In principle this is straightforward to compute for most distributions. The problem, however, is that in many applications of this theory  $n$  is very large;  $n > 10^4$  is common, and in special cases, e.g., image reconstruction,  $n > 10^8$ . We then need to rewrite (3) to be able to carry out the computations.

As a first step let us assume that  $\varepsilon$  has a Gumbel distribution with parameters  $\mu = 0, \beta = 1$ , i.e., a distribution with cumulative distribution function

$$F_\varepsilon(x) = P(\varepsilon \leq x) = e^{-e^{-x}}$$

In that particular case we get

$$\begin{aligned} p_i &= P(\text{An agent chooses object nr } i) = \int_{-\infty}^{\infty} \prod_{\substack{j=1 \\ j \neq i}}^n P(U_j \leq v_i - v_j + x) f_\varepsilon(x) dx \\ &= \int_{-\infty}^{\infty} \prod_{\substack{j=1 \\ j \neq i}}^n e^{-e^{v_j - v_i - x}} e^{-x} e^{-e^{-x}} dx = \int_0^{\infty} \prod_{\substack{j=1 \\ j \neq i}}^n e^{-e^{v_j - v_i} u} e^{-u} du \\ &= \int_0^{\infty} e^{-(1 + \sum_{\substack{j=1 \\ j \neq i}}^n e^{v_j - v_i})u} du = \frac{1}{1 + \sum_{\substack{j=1 \\ j \neq i}}^n e^{v_j - v_i}} = \frac{e^{v_i}}{\sum_{j=1}^n e^{v_j}} \end{aligned} \quad (4)$$

At first sight this may appear as a rather desperate choice to be able to simplify calculations, but that is not so. As  $n$  in applications is very often large, it is natural to consider these results in terms of asymptotic theory.

## 2.1 Asymptotic theory of extremes

Asymptotic theory of extremes is currently a very active topic for research, and several textbooks are available for further study, see, e.g., De Haan and Ferreira (2006). A classical result within that theory is the Fisher-Tippet-Gnedenko theorem which can be stated as follows:

### **Fisher-Tippet-Gnedenko theorem**

*Let  $X_1, X_2, \dots$  be a sequence of IID random variables, let*

$$M_n = \max\{X_1, \dots, X_n\}$$

*If two sequences of real numbers  $a_n, b_n$  exist such that  $a_n > 0$  and*

$$\lim_{n \rightarrow \infty} P\left(\frac{M_n - b_n}{a_n} \leq x\right) = F(x)$$

*then if  $F$  is a non-degenerate distribution function, the limit belongs to the Gumbel, Fréchet or Weibull family.*

For a proof of this theorem see, e.g., De Haan and Ferreira (2006) page 3-10. We see that the Fisher-Tippet-Gnedenko theorem (FTG-theorem) has a similar structure as the central limit theorem. It involves a normalization procedure, and the limiting objects can be characterized by closed form expressions. It is interesting to note that the maximum distribution converges to the Gumbel distribution for a big class of commonly used distributions. To be more precise, the following statements are true:

## Limit theorems

If  $\varepsilon$  is drawn from a

- *normal distribution*
- *lognormal distribution*
- *exponential distribution*
- *gamma distribution*
- *logistic distribution*

then there exist normalizing constants such that the maximum distribution converges to the Gumbel distribution.

See De Haan and Ferreira (2006) for general criterias on how to check the tail conditions of  $\varepsilon$  that has to be fulfilled in order to obtain the Gumbel distribution. If the distribution has finite support, we do not get convergence to the Gumbel distribution. In such cases, however, it is always possible to use a logarithmic transformation to get convergence to the Gumbel distribution. More precisely the following principle holds, see Leonardi (1984): Assume that a non-degenerate limit exist in the FTG-theorem. Using one of the 3 transformations

- $x \mapsto x$
- $x \mapsto \ln[x]$
- $x \mapsto -\ln[(\text{Upper support of X}) - x]$

the transformed variables converges to the Gumbel distribution.

## 2.2 Asymptotic properties of random utility models

Returning to the random utility problem, we observe that we cannot apply the FTG-theorem directly. The  $\varepsilon_i$ -s are IID, but the  $U_i$ -s are not. To position ourselves to invoke the FTG-theorem, we have to equip the choice set with some additional structure. We will now assume that the choice  $\mathbf{S}$  set is infinite, and that it can be partitioned into a finite number of subsets  $\mathbf{S}_1, \dots, \mathbf{S}_m$ .

For  $i$  fixed, all the objects in  $\mathbf{S}_i$  have the same deterministic utility  $v_i$ .

To proceed we now want to draw a large random sample of  $n$  objects from  $\mathbf{S}$ . To carry out the calculations, this sample must contain large subsamples from each  $S_i$ ,  $i = 1, \dots, m$ . We hence assume that there exists weights  $W_i$  such that

$$W_i = P(\text{Choose an object in } S_i) > 0, \quad i = 1, \dots, m$$

To provide some useful intuition we can think of  $\mathbf{S}$  as all the houses in a country. The houses are in towns, and the country has  $m$  towns which differ in relative size. An agent inspects a large number of houses, and selects the house with the largest total utility. We want to compute the probability  $p_i$  that the agent chooses a house in town  $i$ . The idea is now simply to let the agent choose the best house from each town, and let these compete to determine the overall winner.

We draw a large random sample of  $n$  objects from  $\mathbf{S}$ . The sample contains  $n_i$  elements from  $\mathbf{S}_i$ ,  $i = 1, \dots, m$ . By a slight abuse of notation we let  $j \in \mathbf{S}_i$  denote the set of indices  $j$  s.t. the chosen object nr  $j$  is an element in  $S_i$ . We then define  $m$  random variables

$$Z_i = v_i + \max_{j \in \mathbf{S}_i} \varepsilon_j \quad i = 1, \dots, m \quad (5)$$

and get

$$\begin{aligned} p_i^{(n)} &= P(\text{An agent chooses an object in } \mathbf{S}_i) = P(Z_j \leq Z_i, \forall j \neq i) \\ &= \int_{-\infty}^{\infty} \prod_{\substack{j=1 \\ j \neq i}}^m P(\max_{k \in \mathbf{S}_j} \varepsilon_k \leq v_i - v_j + x) f_{\max_{k \in \mathbf{S}_i} \varepsilon_k}(x) dx \end{aligned} \quad (6)$$

The next step is to pass to the limit in (6) as  $n \rightarrow \infty$ . Notice that when  $\varepsilon$  has unbounded support the integrand goes to zero pointwise, hence limit considerations are somewhat subtle. A refined result is considered in the next section, and we refer to Jaibi and ten Raa (1998) for a direct proof. We will hence not be very specific about the conditions in the “proof” below. The intention of this “proof” is to see how these results are linked to the FTG-theorem, and we will simply assume that convergence in the FTG-theorem is sufficiently fast to get convergence

in the expressions below.

Let  $a_k, b_k$ ,  $k = 1, \dots$  denote the normalizing sequences defined in the FTG-theorem. If  $n$  is large, we have

$$p_i^{(n)} \approx \int_{-\infty}^{\infty} \prod_{\substack{j=1 \\ j \neq i}}^m \exp \left[ -\exp \left[ -\frac{v_i - v_j + x - b_{n_j}}{a_{n_j}} \right] \right] \cdot \frac{d}{dx} \left\{ \exp \left[ -\exp \left[ -\frac{x - b_{n_i}}{a_{n_i}} \right] \right] \right\} dx \quad (7)$$

We restrict the discussion to the case where  $\lim_{n \rightarrow \infty} a_n = a > 0$  (a constant), which is essentially what is needed to get a non-degenerate limit. This condition holds, e.g., for the exponential distribution with parameter  $\lambda$  where the normalizing constants are known to be  $a_n = \lambda^{-1}$ ,  $b_n = \lambda^{-1} \ln[n]$ , see, e.g., Billingsley (1995). In that case

$$p_i^{(n)} \approx \int_{-\infty}^{\infty} \prod_{\substack{j=1 \\ j \neq i}}^m \exp \left[ -\exp \left[ -\frac{v_i - v_j + x - b_{n_j}}{a} \right] \right] \cdot \frac{d}{dx} \left\{ \exp \left[ -\exp \left[ -\frac{x - b_{n_i}}{a} \right] \right] \right\} dx \quad (8)$$

Here we can use the same change of variables as we used in (4) to obtain

$$p_i^{(n)} \approx \frac{e^{\frac{1}{a}(v_i - b_{n_i})}}{\sum_{j=1}^m e^{\frac{1}{a}(v_j - b_{n_k})}} \quad (9)$$

If  $v_1 = v_2 = \dots = v_m = 0$ , the limit must be proportional to how often a sample from  $S_i$  is drawn, i.e.

$$\lim_{n \rightarrow \infty} \frac{e^{-b_{n_i}/a}}{\sum_{k=1}^m e^{-b_{n_k}/a}} = \frac{W_i}{\sum_{k=1}^m W_k} \quad (10)$$

Returning to the expression in (9), we see that

$$p_i^{(n)} \approx \frac{e^{\frac{1}{a}(v_i - b_{n_i})} / \sum_{k=1}^m e^{-b_{n_k}/a}}{\sum_{j=1}^m e^{\frac{1}{a}(v_j - b_{n_j})} / \sum_{k=1}^m e^{-b_{n_k}/a}} \approx \frac{e^{\frac{v_i}{a}} W_i / \sum_{k=1}^m W_k}{\sum_{j=1}^m e^{\frac{v_j}{a}} W_j / \sum_{k=1}^m W_k} = \frac{W_i e^{\frac{v_i}{a}}}{\sum_{j=1}^m W_j e^{\frac{v_j}{a}}} \quad (11)$$

If a limiting distribution exist, it must hence satisfy

$$\lim_{n \rightarrow \infty} p_i^{(n)} = \frac{W_i e^{\frac{v_i}{a}}}{\sum_{j=1}^m W_j e^{\frac{v_j}{a}}} \quad (12)$$

The essence of the ‘‘proof’’ above is that we get convergence to the right hand side of (12) whenever the distribution has a tail distribution sufficiently close to the exponential distribution.

### 2.3 Extensions to regular upper tails

Jaibi and ten Raa (1998) extend the discussion in Section 2.2 to a more general setting. A distribution  $F$  has a *regular upper tail* if

$$\phi(c) = \lim_{u \rightarrow \sup\{v | F(v) < 1\}} \frac{1 - F(u + c)}{1 - F(u)} \quad (13)$$

is well defined for all  $c \geq 0$ , and Jaibi and Raa prove that if  $\phi(c)$  is well defined for all  $c$ , then  $\phi(c) = \exp[-\mu c]$  with  $\mu = 0$ ,  $\mu > 0$  or  $\mu = \infty$ . They are then able to prove the following theorem:

#### Theorem (Jaibi and Raa)

If the distribution  $F$  of  $\varepsilon$  has a regular upper tail, then if

- $\mu = 0$  (degenerate case where the deterministic utilities do not matter)

$$\lim_{n \rightarrow \infty} p_i^{(n)} = W_i \quad (14)$$

- $0 < \mu < \infty$

$$\lim_{n \rightarrow \infty} p_i^{(n)} = \frac{W_i e^{\mu v_i}}{\sum_{j=1}^m W_j e^{\mu v_j}} \quad (15)$$

- $\mu = \infty$  (degenerate case where the deterministic utilities are all what matters)

*In the limit agents choose the subsets with maximal deterministic utility with probability 1. If there are more than one such subset, the choices are distributed among these in accordance with their relative weights.*

Returning to our list of commonly used distributions the situation can be summarized as follows:

- Normal distribution

In this case  $\mu = \infty$ , and the subsets with maximal deterministic utility are chosen with probability 1.

- Lognormal distribution

In this case  $\mu = 0$  and alternatives are chosen in accordance with their relative weights.

- Exponential, Gamma and Logistic distributions



In these cases  $0 < \mu < \infty$ , and the choice probabilities converge to the non-degenerate expression given by (15).

### 3 The multinomial logit model

In the previous section we have seen that a random utility model may lead to a non-degenerate choice distribution

$$p_i = \frac{W_i e^{\mu v_i}}{\sum_{j=1}^m W_j e^{\mu v_j}} \quad (16)$$

This expression is commonly referred to as *the multinomial logit model*. In some sense the class of distributions leading to a multinomial logit model within the random utility framework is special. The random term must essentially have the same tail properties as the exponential distribution, which is a quite strong restriction. The multinomial logit model has a wide range of applications, however, and has been an object of intensive studies for many years. The resulting expression is surprisingly robust in the sense that it can be derived from several different lines of approach. We will here mention a few of these lines.

- Maximum entropy considerations

In this theory one wish to find a choice distribution which maximizes entropy subject to a lower bound on the total utility.

- Maximum utility problem

In this theory one wish to find a choice distribution with maximum total utility subject to a lower bound on the entropy.

- Probabilistic cost efficiency

In this theory one wish to construct a probability measure on the choice set with the property that larger total utility of a state implies larger probability for that state.

In all these cases one eventually ends up with the model defined in (16). In conclusion the model defined by (16) hardly rests on a random utility maximization alone, and there could be good reason to apply this model even when the assumptions in the random utility approach appear questionable.

## 4 Applications to real world data

The multinomial logit model has found widespread applications and is used in many different fields. In particular we mention traffic planning, export/import between countries, image reconstruction. To put the asymptotic results in the Jaibi and Raa paper into some perspective, we will consider some real data collected from the transport of coal between the major ports in the world. The example is taken from Ubøe et al. (2009), see that paper for more details on the data. The particular case we have in mind contains export/import data from 2006, and the observed freights are as follows (figures in million tonnes):

$$\mathbf{T}^{\text{obs}} = \begin{pmatrix} 71.91 & 0.62 & 9.2 & 6.15 \\ 24.68 & 7.42 & 0.3 & 0.52 \\ 0 & 0 & 8.6 & 6.46 \\ 28.36 & 14.32 & 103.22 & 40.75 \\ 54.43 & 1.23 & 0 & 0.02 \\ 25.85 & 3.73 & 0.03 & 0 \\ 2.59 & 0.23 & 20.7 & 20.84 \\ 21.48 & 1.67 & 31.55 & 43.21 \end{pmatrix} \quad (17)$$

The entry  $\mathbf{T}_{ij}^{\text{obs}}$  reports the observed export from the exporting port  $i$  to the importing port  $j$ . We want to model this in terms of a multinomial logit model. Clearly an  $M \times N$  matrix can be wrapped into a vector, and we can then formulate our model on the form

$$p_{ij} = \frac{W_{ij} \exp[\beta v_{ij}]}{\sum_{k,l=1}^{M,N} W_{kl} \exp[\beta v_{kl}]} \quad (18)$$

As a next step we want to construct weights  $W_{ij}$  such that the model is consistent with the observed marginal totals. It is natural to impose a multiplicative structure  $W_{ij} = A_i \cdot B_j$ . Let  $|\mathbf{T}^{\text{obs}}| = \sum_{i,j=1}^{M,N} T_{ij}^{\text{obs}}$  be the total export/import volume in the system as a whole. If a total of  $|\mathbf{T}^{\text{obs}}|$  units is distributed one by one unit according to (18), the expected freights  $T_{ij}^{\text{model}}$  satisfies

$$T_{ij}^{\text{model}} = |\mathbf{T}^{\text{obs}}| \cdot p_{ij} \quad (19)$$

Without loss of generality we can assume that  $\sum_{k,l=1}^{M,N} W_{kl} \exp[\beta v_{kl}] = |\mathbf{T}^{\text{obs}}|$  (if not we can just multiply all the weights by a suitable constant), and we then end up with a model on the form

$$T_{ij}^{\text{model}} = A_i B_j \exp[\beta v_{ij}] \quad (20)$$

The key issue is now that long distance between ports represents a disutility in terms of transport, and the simplest version of this principle is then to put

$$v_{ij} = -\text{geographical distance from } i \text{ to } j = -d_{ij} \quad (21)$$

When we have decided on the deterministic utilities, what remains is to tune the so called balancing factors  $A_i$  and  $B_j$  to the observed marginal totals, i.e., *given a value on  $\beta$*  we wish to construct  $A_1, \dots, A_M$  and  $B_1, \dots, B_N$  such that

$$\sum_{i=1}^M T_{ij}^{\text{model}} = \sum_{i=1}^M T_{ij}^{\text{obs}} = \text{Total export from port } j \quad (22)$$

and

$$\sum_{i=1}^N T_{ij}^{\text{model}} = \sum_{i=1}^N T_{ij}^{\text{obs}} = \text{Total import to port } i \quad (23)$$

To satisfy the constraints in (22) and (23) we need to solve  $N + M$  non-linear equations for the unknowns  $A_1, \dots, A_M$  and  $B_1, \dots, B_N$ . Under normal circumstances this could be very difficult when  $M$  or  $N$  are large, but in this special case we have available a numerical method, Bregman balancing, which is capable of handling extremely large system of this type, see ?. In our case the algorithm is surprisingly simple: Initially one puts all the balancing factors equal to 1. As a next step all the  $A_i$  are updated using

$$A_i^{\text{new}} = \frac{\sum_{j=1}^M T_{ij}^{\text{obs}}}{\sum_{j=1}^N B_j^{\text{old}} \exp[-\beta d_{ij}]} \quad (24)$$

then all the  $B_j$  are updated using

$$B_j^{\text{new}} = \frac{\sum_{i=1}^M T_{ij}^{\text{obs}}}{\sum_{i=1}^N A_j^{\text{new}} \exp[-\beta d_{ij}]} \quad (25)$$

The updating is then repeated a number of times until the system comes to rest at a fixpoint

solving the equations. We are now ready to discuss these issues in the light of asymptotic theory. As a first step we consider the case  $\beta = \infty$  which is the kind of pattern we expect to observe if choices are made from random utility maximization with, e.g., a normally distributed random term. Strictly speaking the model in (20) does not make sense in this case. Nevertheless the limit when  $\beta \rightarrow \infty$  can be shown to exist and converges to a matrix where the total transportation distance in the system is as small as possible. This corresponds to the case where 100% emphasis is put on the total transportation cost, and the final result are as follows:

$$\begin{array}{cc}
 \left( \begin{array}{cccc}
 71.91 & 0.62 & 9.2 & 6.15 \\
 24.68 & 7.42 & 0.3 & 0.52 \\
 0 & 0 & 8.6 & 6.46 \\
 28.36 & 14.32 & 103.22 & 40.75 \\
 54.43 & 1.23 & 0 & 0.02 \\
 25.85 & 3.73 & 0.03 & 0 \\
 2.59 & 0.23 & 20.7 & 20.84 \\
 21.48 & 1.67 & 31.55 & 43.21
 \end{array} \right) & 
 \left( \begin{array}{cccc}
 87.89 & 0 & 0 & 0 \\
 32.93 & 0 & 0 & 0 \\
 0 & 0 & 15.06 & 0 \\
 23.21 & 29.23 & 134.22 & 0 \\
 55.68 & 0 & 0 & 0 \\
 29.61 & 0 & 0 & 0 \\
 0 & 0 & 24.34 & 20.02 \\
 0 & 0 & 0 & 97.92
 \end{array} \right) \\
 \text{Observed flows} & \text{Modelled flows } (\beta = \infty)
 \end{array}$$

One would maybe expect that transportation costs are very important, but as we can see from the observations the observed matrix is very far from the case featuring minimal total transportation cost. In particular we notice the shaded entries where the two matrices are very different, and whatever measure of fit we would use would lead us to conclude that the overall fit is very bad.

One explanation could be that the freight cost is so small compared with other expenses that it has no impact on trade. If that is the case one would expect to observe a trade pattern where freights are distributed in proportion to the total import/export from each port. That would correspond to the case  $\beta = 0$  which is what we get from random utility maximization when the random term has, e.g., a lognormal distribution. Data does not support that conclusion, however. If we carry out the calculations we get

$$\begin{pmatrix} 71.91 & 0.62 & 9.2 & 6.15 \\ 24.68 & 7.42 & 0.3 & 0.52 \\ 0 & 0 & 8.6 & 6.46 \\ 28.36 & 14.32 & 103.22 & 40.75 \\ 54.43 & 1.23 & 0 & 0.02 \\ 25.85 & 3.73 & 0.03 & 0 \\ 2.59 & 0.23 & 20.7 & 20.84 \\ 21.48 & 1.67 & 31.55 & 43.21 \end{pmatrix}$$

Observed flows

$$\begin{pmatrix} 35.28 & 4.5 & 29.64 & 18.47 \\ 13.22 & 1.68 & 11.1 & 6.92 \\ 0 & 0 & 9.28 & 5.78 \\ 74.93 & 9.55 & 62.95 & 39.22 \\ 33.72 & 4.3 & 0 & 17.65 \\ 15.05 & 1.92 & 12.64 & 0 \\ 17.81 & 2.27 & 14.96 & 9.32 \\ 39.31 & 5.01 & 33.03 & 20.58 \end{pmatrix}$$

Modelled flows ( $\beta = 0$ )

Inspecting the two matrices it is hardly possible to see any similarities, and whatever measure of fit one would like to use would lead us to conclude that the overall performance is very bad.

What remains is to tune a non-degenerate multinomial logit model to the observations. That would provide a matrix corresponding to a random utility maximization with an error term that has, e.g., exponential distribution. The best model fit (in the sense of maximum loglikelihood) is obtained using  $\beta = 0.000201163$ . That may appear to be small, but notice that distances are measured in miles between the ports, and that the typical magnitude is 5000 miles. The final results are shown in the matrices below.

$$\begin{pmatrix} 71.91 & 0.62 & 9.2 & 6.15 \\ 24.68 & 7.42 & 0.3 & 0.52 \\ 0 & 0 & 8.6 & 6.46 \\ 28.36 & 14.32 & 103.22 & 40.75 \\ 54.43 & 1.23 & 0 & 0.02 \\ 25.85 & 3.73 & 0.03 & 0 \\ 2.59 & 0.23 & 20.7 & 20.84 \\ 21.48 & 1.67 & 31.55 & 43.21 \end{pmatrix}$$

Observed flows

$$\begin{pmatrix} 79.66 & 3.64 & 2.79 & 1.8 \\ 25.26 & 2.03 & 3.62 & 2.02 \\ 0 & 0 & 9.66 & 5.4 \\ 39.55 & 9.6 & 85.64 & 51.87 \\ 37.65 & 8.44 & 0 & 9.58 \\ 21.88 & 2.63 & 5.1 & 0 \\ 3.95 & 0.65 & 24.11 & 15.65 \\ 21.37 & 2.23 & 42.7 & 31.62 \end{pmatrix}$$

Modelled flows ( $\beta = 0.000201163$ )

Of course one can notice some differences between the two matrices. When we evaluate this we should keep in mind that we only have one explanatory variable, geographical distance. Taking

into account that our model only has one degree of freedom, the overall performance is no less than remarkable. In fact inspection of the model fit can lend support to an almost religious belief that agents in this business are utility maximizers with a exponentially distributed random term, but that is maybe going far over the line.

## 5 Concluding remarks

We have presented a survey of the relationship between random utility theory, extreme value theory and multinomial logit models. It has been shown that a Gumbel distributed random utility leads to multinomial choice probabilities. Furthermore, it has been shown that the assumption of a Gumbel distribution in some cases is not required to obtain this result. This however, requires a particular tail behaviour of the random utility distribution. An empirical example on shipping of coal illustrates that a multinomial model corresponding to distributions with this particular tail behaviour can indeed be empirically plausible.

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