

Colombo's Hour of Trial

Sri Lanka is administered another massive dose of political shock therapy by incurable saboteurs. It is not just a suicide bomber that killed Opposition Presidential candidate Gamini Disenayake, his key political associates and so many others, suicidal quite clearly has also been the fallout of that tragedy. For, this has led to re-imposition of emergency and indefinite curfew and what is even more shocking, set back the peace process started with the LTTE. Moreover, Prime Minister Kumaratunga's cabinet has decided to postpone the Presidential election due on November 9.

We are deeply touched by the death of so many national political leaders of Sri Lanka including that of Premadasa last year. Our heart goes out in sympathy for the loss, too, of great many Sri Lankan souls who attend public meetings out of enlightened civic urges. As wellwisher of that endearing island country and a SAARC fellow-member, we cannot but feel greatly perturbed at how the country ran into deep trouble when it just about looked like being on the mend.

Sri Lanka would hopefully be able to gird up better for future when the mastermind behind the mayhem will have been identified duly by the investigation that is to get underway, with the assistance, perhaps, of foreign experts. The Tamil Tigers have denied they have had a hand in it and we won't guess anything except to say the obvious which is that it has been the handiwork of some incurable rebels. They must have felt reduced to a tiny minority before the spurt in reconciliatory activities that the new government of Chandrika Kumaratunga had set in motion with an active and open cooperation from the LTTE leaders. Pathologically unaccustomed to ways of peace, these elements may have fallen out with their former colleagues and acted on their own. The first round of peace talks with the LTTE ended successfully with exchange of prisoners as between the Tamils and the Sinhalese. After the second encounter with them, the government was examining the rebels' demand for a ceasefire with the military. Such advances could not be to the liking of trouble-mongers. A major effort at peace making was scuttled by rebels in 1990.

One school of thought, including the Sri Lankan Army, took the view that the Tamil Tigers were using the talks to regroup, re-arm and strengthen their bases, a process that might be intensified if they were to have a ceasefire with the military which was under consideration of Kumaratunga's government. The military have not taken kindly to the talks with the LTTE and to ceasefire in particular. Prime Minister Kumaratunga is on record having stated: "The army up until now has reigned supreme — they have been a government unto themselves." She wanted the military not to interfere in her efforts to end the 11-year war with the insurgents fighting for a separate homeland. But ironically after the Colombo massacre on Monday, sweeping powers will now be exercised by the military and the police under a re-clamped emergency.

The United National Party of the deceased opposition Presidential candidate Disenayake has been a hardliner in its approach to the Tamil Tigers. Disenayake himself said he was on the hit-list of Tamil rebels. His premonition has proved to be true. Our hope is there will be no anti-Tamil backlash in Sri Lanka.

Parallel to the handling of Tamil insurrection, there has been the animated political question of re-fixing the equation between the prime minister and the all-powerful president in a structural way. From this point of view the forthcoming presidential election is so important in that country.

A deep-seated political terrorism is affecting the growth of democracy and ethnic coexistence in Sri Lanka, a scourge that we believe this island country, as a member of SAARC, and a signatory to the convention on terrorism, will be able to get over, sooner than later.

Cleaning up Manpower Export

That the government is contemplating tough measures against illegal practices by manpower recruiting agencies through an amendment to the Emigration Ordinance, 1982, is welcome. Sure enough when most other means are exhausted in trying to achieve the desired results, stricter laws can be put in place to act as a deterrent against crimes. Not that the approach guarantees a fail-safe system in manpower export with the temptation of making easy money but at least the manpower agencies will be forced to limit their illegal activities.

However, no denying the fact that stricter laws alone are hardly a remedy for the problem. One of the provisions under consideration is that any agent found at fault or unable to comply with the agreement will be made to compensate for the financial losses incurred by the job-seekers. This is on top of imprisonment or fines or maybe both, in case of the agent resorting to fraudulent practices or cheating the innocent people seeking employment abroad. Certainly an improvement on the existing provisions for dealing with the dishonest recruiting agencies.

Now the crux of the problem is that wrongdoings have to be proved, first of all. It is as problematic as the proverbial belling of the cat. In the illegal operation the manpower export houses hardly keep any documents and witnesses. They rely more on double dealing than on fairplay. Cashing in on the irresistible urge for foreign employment and people's lack of knowledge in the matter of official procedures, some manpower agents find enough leeway to cheat the common people and skirt around the relevant laws.

What is thus crucially important is monitoring the recruiting agents' operations. It is not enough to blacklist an agency for irregular practices, it should be meted out the punishments now under consideration. The last of the provisions that concerns creation of special tribunals provides us with a cue. It is for strengthening supervision of the recruiting agents' operations. The setting up of a tribunal can be justified if there is an effective system of vigilance to evaluate the working of the manpower export agencies. This will facilitate the rounding up of the corrupt agents immediately after the offence has been committed. People who hand a huge amount of money over to the agents are always at the receiving end. To collect the money they have to, most of the time, part with their last resorts. With the passage of time their cases get lost. It is exactly here that the government needs to act promptly to retrieve the situation for them and also to punish the corrupt agents.

Is free international trade economically efficient? The discussion on this question has been very long in which most of the leading figures in international trade theory have participated. If we take the Paretian view of efficiency meaning whether free trade opens the possibility of an unambiguous welfare improvement, then, the answer generally is yes particularly from a cosmopolitan point of view. It is also yes from a narrower national point of view, although one should add a "but" and what follows after the "but" depends on the particular model describing the basis of trade. As with other policy issues, if the model is not made explicit, and informed argument over real issues can turn into a shouting match.

The Competitive Model: The simplest case for free trade is derived from the competitive model. In this model, laissez faire in general and free trade in particular is Pareto optimal. Foreign trade expands the static consumption possibilities by providing an indirect technology of transforming domestic resources into more goods and services than would be possible in autarky.

This does not mean every single individual is better off relative to autarky. However, as long as the terms of trade is different from the autarky relative price, the total gains from trade to the national as a whole is positive implying that the gains to the gainers is larger than the loss to the losers. The gainers, therefore, could potentially compensate the losers and still remain better off. In this sense, international trade is a 'free lottery'.

Economics of Distortions: An immediate objection is that the competitive market scenario underlying this argument is unrealistic. Hence the conclusion about the efficiency of free trade is suspect and should be reconsidered.

Endogenous distortions are widespread primarily due to market imperfections, such as external economies, monopolistic or oligopolistic market structures and imperfect internal factor mobility. As a result, commodity prices do not equal marginal costs and factor price differentials exist in equilibrium. Distortions also arise from the spillover effects; effects on parties other than those agreeing to buy and sell

From around the early 1970s onwards, there has been a strong resurgence of interests in Game Theory especially through the analysis of bargaining. Its analytical tools have become so powerful and sophisticated in recent years that they cannot only provide a whole range of possible solutions to the most complex problems but also deep insights into motivations, incentives and the institutional setup of the players involved in the conflict situation. It is quite natural that the current political crisis in Bangladesh becomes a prime subject for the application of Game-theoretic tools. But one does not come across any such treatment of the present crisis in the major journals of the country. In such a state, when one finds a short article by Professor Wahiduddin Mahmud on "The Politics of Brinkmanship — a Game-theoretic Interpretation" published in the Opinion Column of The Daily Star, September 18, 1994, one reads it with interest and enjoyment. No doubt, his short piece has aroused at least some curiosity among the common readers on the subject apart from the academic interest among the professionals.

PROFESSOR MAHMUD'S FRAMEWORK
Professor Mahmud wrote "Let us think of the on-going confrontation between the government (GV) and the opposition (OP) as a strategic game in which each side can choose among three options, that is either to remain unyielding (U) in its present position, or to surrender (S) to the demands of the other side, or to offer a compromise (C) (which the other side may or may not accept)". This gives a reasonable set of strategies that the players of the present political game can choose from. However, the framework he has worked with is a static, zero-sum, non-cooperative, and two-party game with each party having three pure strategies. These terminologies need some explanation.

Why consumers?
Sir, Recently I went to one of my friends' house at Bakshipara Lane in Khulna. There I happened to witness an 'uncommon phenomenon'. Commonly known as load-shedding which is a regular feature in our domestic power supply, just that occurred but with a glimpse of excess shine before being all dark. After normal waiting, when the supply didn't come at all, suspicion grew whether some major breakdown had occurred. However, after a while it was known that it was a big voltage fluctuation. Consequently the damage caused to the consumers was massive. Almost every family in the locality had to have a toll of their electronic goods that were in use.

The Traditional Case for Free Trade

by Zahid Hussain

There are not many debates in economics that generate as much passion and intensity as the debate on international trade policy. This debate needs to be distinguished from the more general debate on laissez faire and interventionism. An economist can be against laissez faire while at the same time being for free international trade.

The objective here is to briefly survey the debate on trade policy. The intended audience are primarily the trade policy makers who want to know the current state of the debate and students of international economics who want a quick acquaintance with the important positions on trade policy within the mainstream economics.

in a marketplace. Suffice it to say that we do not live in the "first best" world. The real world is riddled with gaps between private and social benefits and costs. As long as these gaps exist, private actions will not lead to a social optimum.

In the context of a fully informed, omnipotent, and benevolent social planning authority, interventions can be Pareto improving in a second best world. But not any intervention. The framework for analyzing interventions in the presence of distortions was developed in the 50s and 60s by James Meade (1955), Jagdish Bhagwati and VK Ramaswami (1963) and Harry Johnson (1963). Extensive theoretical investigations have produced one general conclusion: Interventions should directly attack the distortion at its source. This is known as the 'specificity rule'.

Application of the specificity rule leads to a much more sophisticated and subtle economic case for free trade. The policy message is essentially the following. Domestic distortion can be dealt with by introducing another domestic distortion that just offsets the initial distortion. An international distortion will not do this and may or may not increase the country's economic welfare because it is not aimed at the source of the distortion. International policies are proper only in the presence of an international distortion.

Scale Economies and Market Imperfections

Adam Smith and Joseph Schumpeter pioneered the cause of free trade on the plausible assumption that the division of labor is limited by

the size of the domestic market. Integration of national markets provides benefits from scale economies and from intensified producer rivalry. Such effects, often termed the dynamic effects of trade, though hard to formalize and measure, are of far greater importance than the more theoretically tractable static consumption and production gains.

With decreasing opportunity costs arising from the presence of internal economies of scale, even totally similar economies can engage in mutually beneficial trade, unlike the traditional case, based on increasing opportunity costs, where countries must differ in terms of cost conditions for trade to be mutually beneficial. With trade, one nation could specialize completely in one product and the other could specialize completely in the other. The specific pattern of specialization does not matter.

Graham (1923) cracked this optimism about trade by constructing a numerical example which attempted to show that when a country has a sector with increasing returns to scale and a sector with decreasing returns to scale, it may lose from trade.

It soon became clear that losses from trade are indeed possible when economies of scale are present in some industries. Since assumptions about technology and market structure are not independent, an argument about the possibility of a country losing from trade must be made with explicit modelling of the market structure. Without doing that it is difficult to figure out how and why the loss may in fact occur and whether other miti-

gating factors may also be present at the same time.

Helpman and Krugman (1986) have investigated the welfare effects of trade in models with economies of scale and imperfect competition. They find that in a world which deviates from the perfect competition/constant returns to scale norm of standard theory, there are increased potential gains from trade on the one hand, and there also is the possibility that a national economy may fail to take advantage of these potential gains and end up losing.

The additional potential gains come from four sources. First, trade can expand a country's increasing returns to scale industries on average. This 'own production effect' can be viewed as a kind of technological progress that raises the efficiency of the economy. Second, under some circumstances (external economies, contestable markets), trade leads to a 'concentration' of each increasing returns industry in a single country. Such concentration creates a presumption of large scale of production worldwide than any one country would have had in autarky. This in turn implies that prices of increasing returns goods will fall, benefiting even countries that cease their production as a result of trade. Third, trade tends to increase output per firm in increasing returns industries leading to increased productivity. This is the 'rationalizing' effect of trade. Finally, a trading world economy can provide a greater variety of products than any one country. Trade increases a nation's 'product diversity'.

Except the first, there is a clear presumption of positive effects on welfare due to trade. The major source of uncertainty is the own production effect. It is easy to imagine situations where trade leads to a contraction of those sectors that either produce with increasing returns or are highly monopolized. But the practical importance of this possibility does not appear to be great.

Even if a country's production in increasing returns or imperfectly competitive industries falls as a result of opening trade, the other effects will still tend to work in its favor. There is, therefore, an overall presumption that trade remains beneficial in a world characterized by economies of scale and imperfect competition.

Technology Gaps
Traditional trade theory assumes identical production technologies across nations. In a world of constantly changing technology this is equivalent to assuming instantaneous international diffusion of product and process innovations. There are evidence that the post World-War II era is characterized by large differences in the rate of research and development (R & D) expenditures. The sectoral pattern of innovations in each country and across countries is quite stable over time. Consequently, there exist significant and persistent productivity differences — technology gaps — across nations.

The technology gaps give rise to absolute cost advantages which in turn determine the competitiveness of nations. Competitiveness based on ab-

solute advantage dominates sectoral comparative advantages in the determination of trade flows because of sectoral interdependencies and the external effect of innovative capacity. Thus, advanced countries generally show higher participation in terms of world export market share in world trade in the sectors of comparative disadvantage than the backward countries in the sectors of comparative advantage. Comparative advantage determines the level and composition of trade only in the special case of perfect competition in product and factor markets and when there are no technology gaps.

There is nothing fundamentally new about the role of technology gaps international trade. Raymond Vernon (1966) made a similar departure from the theory of comparative advantage in his 'product cycle' hypothesis. He predicted that new products will be first produced in the country where they are first demanded and then be exported from there. Later as the product matures and becomes standardized, production will move to lower cost locations. This idea was formalized later by Krugman (1979).

This views are not explicit on their implications for gains and losses from international trade. It is plausible to assume, however, that compared to autarky, trade that follows technological gaps is probably mutually beneficial. It cannot be immiserizing because immiserization requires and expansion in trade that already existed. As Lindert (1991) argues in the context of Vernon's hypothesis: 'to weight the welfare effect of trade in a new product, one must compare it with no trade at all in that product. Therefore, having new-product trade follow the product cycle cannot spoil any country's terms of trade (there was no previous export price to lower)'. Such a presumption is natural also in models where technology gaps arise endogenously from accumulation and innovativeness.

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Next Week: Arguments for Intervention

OPINION

On Game Theory and the Current Political Crisis

Dr Kabir U. Ahmad

Static game means that each player can choose one and only one element from a set of possible strategies and the game then ends. In other words, there is no scope for any player to respond sequentially to the choices of strategies of his opponent. Also time does not enter as a determinant and hence it is a one-shot game. Zero-sum game means that the total pay off (returns or benefits) of the game cannot be divided among players; that is, if one gets the pay-off the other player does not get anything. In the political game that is being considered here, the situation seems to be such that if the OP gets what it wants (eg the establishment of a caretaker government before the election) then the GV loses its anchored position on the issue. This also shows that it is a non-cooperative game implying that there is no implicit sharing of the returns of the game among the players in any agreed ratio like 3/4 or 1/2 or 5/6 etc. This latter feature is the characteristic of a cooperative game. Finally, a game with 'pure' strategies means that the number of choices of strategies to a player in any game is finite. What it means is that a player cannot choose any (linear) combination of his available strategies.

Now, given the above characteristics of the model, Professor Mahmud asserts that "Depending on how each side will use its options, this game will end in producing any one of the following four alternative outcomes: (a) the government concedes to the opposition's demand for a caretaker government, (b) the opposition gives up its demand in favour of the government's position of holding election under the present party rule, (c) both sides agree for a compromise solution

(say, a national government with representation from various parties according to some agreed formula); and (d) the confrontation, being unresolved, leads to a disaster."

Now, a game of two parties each having three pure strategies will have nine possible outcomes and not four. It is worth showing these nine outcomes systematically. Think of a two-way table (or a matrix) placing GV on the top side with the strategies U, S, C placed in that order from left to right so as to create the vertical columns under each of these strategies (ie column U, column S and column C). Then put OP on the left side of the table with its strategies U, S, C placed vertically (ie first put U, then put S below U and then put C below S) so that one can look across the table beginning with U, S and C respectively to create three rows. This arrangement is just to create the two-way table with nine cells taking one element from the OP's strategies and another corresponding element from the GV's strategies which give the total number of possible outcomes. It has nothing to do with the actual choices of the two parties. Now, looked at from the left or the OP's side, the table will have the following three rows each with three possible outcomes: in the first row, where the OP's strategy U is combined with the GV's strategies U, S, and C respectively gives rise to (1) UU, (2) US, and (3) UC; similarly in the second row, where the OP's strategy S is combined with the GV's same strategies, gives rise to (4) SU, (5) SS, and (6) SC; and finally, in the third row where the OP's strategy C is combined with the GV's same strategies gives rise to (7) CU, (8) CS and (9) CC. It

is now clear that the total possible outcomes cannot be any more or any less than nine.

All these need to be interpreted carefully in order to understand what these mean. The outcome "(1) UU" means that both the GV and the OP are unyielding and hence no solution to the crisis; the outcome "(2) US" means that the OP is unyielding while the GV is willing to surrender which is the ideal solution for the OP; the outcome "(3) UC" means that the OP is unyielding while the GV is willing to compromise which is the next best solution for the OP; the outcome "(4) SU" indicates that the OP is willing to surrender while the GV is unyielding which is an ideal solution for the GV and is an exact opposite of (2); the outcome "(5) SS" shows that both parties are willing to surrender to their opponent's demands which is an unbelievable but possible situation to develop when both parties will run for their life, as it were; the outcome "(6) SC" shows that the OP is willing to surrender but the GV is interested in the compromise, which would be almost like the GV showing mercy to the OP to save them from humiliation; the outcome "(7) CU" indicates that the OP is willing to compromise while the GV is unyielding, which is an exact opposite of (3) above; the outcome "(8) CS" indicates that the OP is willing to compromise while the GV is prepared to surrender, which is again an exact opposite of (6); and finally the outcome "(9) CC" means that both parties are willing to compromise, a rational attitude of both the parties which can lead to a resolution of the crisis. Now, all these possible outcomes could not be visualised

without such rigorous representation of all the possible combinations of strategies of the players.

Given this set of total possible outcomes, it is easy to see now which subset of four outcomes Professor Mahmud was talking about and which other subset he has left out. They are as follows: the outcome "(2) US" was his (a), the outcome "(4) SU" was his (b), the outcome "(9) CC" was his (c) and the outcome "(1) UU" was his (d). The other subset of five possible outcomes was left out. But if it is the OP is unyielding while the GV is willing to compromise which is the next best solution for the OP; the outcome "(4) SU" indicates that the OP is willing to surrender while the GV is unyielding which is an ideal solution for the GV and is an exact opposite of (2); the outcome "(5) SS" shows that both parties are willing to surrender to their opponent's demands which is an unbelievable but possible situation to develop when both parties will run for their life, as it were; the outcome "(6) SC" shows that the OP is willing to surrender but the GV is interested in the compromise, which would be almost like the GV showing mercy to the OP to save them from humiliation; the outcome "(7) CU" indicates that the OP is willing to compromise while the GV is unyielding, which is an exact opposite of (3) above; the outcome "(8) CS" indicates that the OP is willing to compromise while the GV is prepared to surrender, which is again an exact opposite of (6); and finally the outcome "(9) CC" means that both parties are willing to compromise, a rational attitude of both the parties which can lead to a resolution of the crisis. Now, all these possible outcomes could not be visualised

However, if one now asks: which strategy will each party select? The standard answer is that it depends on the preferences of the players over the available set of strategies. But in a rapidly changing, unpredictable and chaotic situation, preferences of the players may not only change, they may even be reversed.

THE PRESENT NATURE OF THE DYNAMICS

1. Since the end of the current parliamentary period is just about 15 months away, from the point of view of time preference the present period has a greater weight than the future/terminal period. This makes the politicians more sensitive to what actions they choose now that will have a bearing on their terminal year results. Whether the players of the present game in Bangladesh understand the implications of time preference or not, it will have an influence on their behaviour especially on their choice of strategy in the immediate period. Seen from this perspective, one can appreciate why the OP is favouring strong action and using harsh language in recent months. This is being reciprocated by the GV in no less strong terms.

2. Over the last few months both the OP and GV seem to be playing a two-level game: on the surface, both parties are showing signs of dialogue for compromise while on the ground the OP is conducting mass meetings, strikes, rallies and siege, etc which have prompted the GV also to hold similar mass meetings and rallies. From the newspaper reports, it seems the Prime Minister's meetings are attracting larger crowds than those of the OP leader. In the competition for greater mass support, the OP would be, willy nilly, driven to take stronger action which might eventually create a 1990-type political upheaval forcing the GV to resign which is what it wants.

ties and entrenched positions of the parties have some implications: (a) the dialogue and the actions on the ground are just two different forms of the same game, (b) the OP's basic preference is for strategy U over C, and the strategy S is not on their agenda and hence it can be ignored, (c) while strategy C and its terms have not yet been specified, they may be evolving if the dialogue continues, and (d) the GV's preference also seems to be U over C, and S does not appear to be one of its strategies any more.

What follows from all this is that both the OP and GV have only two strategies each, U and C, and not three. This reduces the structure of the game from two-party three strategies to two-party two strategies with only four possible outcomes: UU, UC, CU and CC. In this set of four outcomes, there is no doubt that UU can be called a "disaster" and CC seems to be the "best hope" for the country. But whether the preferences of both parties from their present pattern of U over C can be reversed to C over U that can lead both the parties to a meaningful compromise is the moot question.

3. Can this 'Preference Reversal' Take Place?

That will depend on: (i) how skillfully the Commonwealth negotiators create an area of mutual gains for both the parties in the bargain which can provide incentive for negotiation; (ii) whether the two parties are willing to place the long-term national interests above their short-term party interests, which calls for objective and rational evaluation of the social gains and losses; and (iii) whether the OP finds the prospect of achieving its objective (ie, the caretaker government before election) through direct mass action. If it perceives this to be feasible, then the Commonwealth brokered negotiation is likely to fail. If it does not, then the OP is most likely to go for compromise.

4. However, some hopeful signs seem to be slowly emerging from the self-realizations of both the players: both sides seem to be aware of their strengths, weaknesses and mistakes which have had sobering effects on their recent behaviours, the GV has shown restraint and wisdom in dealing with the demonstrators by not providing them with additional ammunition (like firing on the demonstrators) which would further intensify the mass agitations; the OP seems to be realising that its chance of overthrowing the GV through 1990-type mass upsurge is not more than 50:50 which is risky and highly costly; and the outside well-wishers seem to be searching for constructive basis for compromise.

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To the Editor

Choice of a school
Sir, It is one of the most important decisions that parents have to make. Which school is best for your child? Any sensible parent will visit a number of schools before making the crucial decision. With the gradual move of education to the private route, parents are now getting greater choices in the types of schools on offer — government schools, grant-maintained schools, selective private schools and schools with specialities such as music, art or sport.

Again, vital information are available now to compare between schools. Teachers and school authorities are easily approachable for all kind of statistics, especially the examination results (SSC/GCSE levels) which are a useful tool for measuring the performance of schools and teachers, not to mention the educational merits of its pupils.

Parents must also look for the history, extra-curriculum activities and the approach to discipline of the school. A good school for some is usually a good school for all.

As we prepare to meet the challenges of the 21 century, we would need to prepare our young generation — they must get adequate qualifications and skills, above all, the discipline that they would be taught in schools must ensure them a sound journey towards self-enlightenment in future years.

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