

Determining the Best Tradeoff Between Expected Economic
Return and the Risk of Undesirable Events When Managing
a Randomly Varying Population

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ABSTRACT

Conditions are given that imply there exists policies that "minimize risk" of undesirable events for stochastic harvesting models. It is shown that for many problems, either such a policy will not exist, or else it is an "extreme" policy that is equally undesirable. Techniques are given to systematically tradeoff decreases in the long-run expected return with decreases in the long-run risk. Several numerical examples are given for models of salmon runs, when both population-based risks and harvest-based risks are considered.

Keywords: Markov decision processes; risk; salmon management; Pareto optimal policies; tradeoff curves; linear programming.

An important consideration in managing ecosystems or wildlife populations is the avoidance of undesirable occurrences, either to the populations themselves, or to the economic agents acting on them. This might mean minimizing the chance that a population becomes too small; or minimizing environmental damage; or perhaps minimizing the chance that the economic return is too small. Such ideas of minimum risk are inherent in such legal concepts as optimal sustainable population (OSP), required for the management of marine mammals in the U.S., or in management under extended jurisdiction, where both the health of the stocks and the health of the industry are vital concerns.

Underlying these concerns is some notion of risk or uncertainty in our management measures. This can arise from two causes. The first cause of risk is risk in the system itself. For example, if oceanographic systems affect fish stocks, we cannot with certainty predict the stock size next year, but only predict with given probability. The second cause of risk is uncertainty about these probabilities. This second cause presumably would diminish as more and more observations are made, and our knowledge about the system increases.

In this paper we are concerned with the first cause of risk--true uncertainty in the system. The results and techniques can be extended to include the second case also (for extensions in related areas see Rieder (1975) or van Hee (1978)). Risk enters our decisionmaking process in three ways. Firstly, in constructing the probabilities

of occurrence of given events. Secondly, in the decisionmaker's attitude towards risk, e.g., how much of a gamble will be tolerated in order to obtain a possibly higher total return. And finally, the policy selected can be analyzed for the degree of risk that it entails.

In this paper, an effort is made to make precise the rather vague decisionmaking goal of "minimizing risk" in a dynamic context. We will see initially that intuitively appealing definitions lead to policies that are not reflective of the true complexity of the problem (section III). As an alternative, acceptable tradeoffs between low risk in the long run and high expected economic return must be found. To this end, the concept of a "Pareto optimal solution" is introduced, and its uses in evaluating tradeoff curves are explored (section IV). Several numerical examples of the techniques of section IV are presented in section V.

II. The Model

We restrict our attention to single species models without age structure. Many of the results extend readily to more complex models, but they neither help demonstrate the limitations of a notion like "minimize risk," nor do they make any clearer the alternative methods proposed. Hence only simple models will be explored. At the beginning of each period t , the population size is "observed" to be x_t . During period t , z_t of the population is removed, leaving a population size of $y_t = x_t - z_t$ at the end of period t . The population

size at the beginning of period $t + 1$ is assumed to be a random function of y_t , that is:

$$x_{t+1} = D_t s[y_t] \quad ; \quad D_t \geq 0 \quad \text{w.p. 1.} \quad (2.1)$$

where D_1, D_2, \dots are independent, identically distributed random variables distributed as the generic variable D .

A one-period decision rule in period t is any rule that tells us that if x_t is the observed state at the start of period t , then take action y_t (e.g., harvest z_t), and does so for all possible values of x_t . A policy π is a sequence of decision rules; that is, an n -period policy π_n would be defined as:

$$\pi_n = \{\delta_1, \delta_2, \dots, \delta_n\}$$

Consider the following two problems:

(i) for fixed ω , "minimize" $\Pr\{x_t \leq \omega\}$ for all t (2.2a)

(ii) for fixed η , "minimize" $\Pr\{z_t \leq \eta\}$ for all t (2.2b)

This implies finding some infinite horizon policy π^* such that this probability is always smallest.

To make this more precise, we need to define the notion of stochastic dominance (Lehmann 1966; Keilson 1974; Barlow and Proschan 1975; O'Brien 1975). For two random variables x and y defined on a common probability space Ω , let F be the distribution function of x and G the distribution function of y . Then x is said to be stochastically dominant over y , written $x \stackrel{ST}{\geq} y$ if and only if:

π
lower case
pi

δ
lower case
delta

lower case
omega

lower case
eta

Ω
capital
omega

ϵ
lower case
epsilon

$$F(x(\omega)) \leq G(y(\omega)) \quad \text{for all } \omega \in \Omega$$

that is the random variable y has a distribution function that always has more total accumulated probability at lower values. It is easy to see that if $x \geq y$, then:

$$\Pr\{x \leq \omega\} \leq \Pr\{y \leq \omega\}$$

for all ω .

0
zero

In comparing two Markov chains $\{x_n, n \in N_0\}$ and $\{y_n, n \in N_0\}$ defined on a common probability space, $\{x_n\}$ is said to be stochastically dominant over $\{y_n\}$ if:

$$x_n \geq y_n \quad \text{for all } n \in N_0$$

This implies (2.2a) or (2.2b); as we shall see, it is a useful concept.

III. Policies That Are Stochastic Dominant

Our first theorem can be motivated by considering the one-period problem: for a given x_1 , choose a y_1 such that:

$$D_1 s[y_1] \geq D_1 s[y] \quad \text{for } 0 \leq y \leq x_1$$

where $s[\cdot]$ is assumed to be unimodal.

Now:

$$\Pr\left\{D_1 s[y_1] \leq \omega\right\} = \Pr\left\{D_1 \leq \frac{\omega}{s[y_1]}\right\}$$

Consider the policy δ_1^* defined by:

$$\delta_1^* = \text{minimum } \{y_{\max}, x_1\}$$

where y_{\max} is the argument where $s[\cdot]$ achieves its mode. Then, for any other feasible decision rule δ_1 :

$$s[\delta_1^*(x_1)] \geq s[\delta_1(x_1)] \quad \text{implies}$$

$$\frac{\omega}{s[\delta_1^*(x_1)]} \leq \frac{\omega}{s[\delta_1(x_1)]} \quad \text{implies}$$

$$\Pr\left\{D_1 \leq \frac{\omega}{s[\delta_1^*(x_1)]}\right\} \leq \Pr\left\{D_1 \leq \frac{\omega}{s[\delta_1(x_1)]}\right\}$$

which is the desired result.

Theorem 3.1 formalizes this result; the proof is given in the appendix, as are all the proofs in this paper

Theorem 3.1 In (2.1), assume $s[\cdot]$ is unimodal and obtains its mode at y_{\max} . Define the policy $\pi^* = \{\delta_1^*, \delta_2^*, \dots\}$ where:

$$\delta_t^* = \text{minimum } \{x_t, y_{\max}\}$$

Let $\{x_n^{\pi^*}\}$ be the Markov chain that arises from following π^* , and $\{x_n^{\pi}\}$ be the Markov chain that arises from following any other feasible policy π . Then:

$$x_n^{\pi^*} \stackrel{\text{ST.}}{\geq} x_n^{\pi} \quad \text{for all } n.$$

□

The assumption that $s[\cdot]$ is unimodal is weak, as most standard production models satisfy this assumption. The specific form $x_{t+1} = D_t s[y_t]$ is also common; see for example the models of salmon runs in Bristol Bay developed by Mathews (1967).

It is worth comparing the policy that arises from theorem 3.1, with the policy that:

$$\begin{aligned} & \text{maximizes } E \left\{ \sum_{t=1}^{\infty} \alpha^{t-1} p \cdot (x_t - y_t) \right\} \\ & \text{s.t. } x_{t+1} = D_t s[y_t]; \quad 0 \leq y_t \leq x_t \end{aligned} \tag{3.1}$$

and $s[\cdot]$ restricted as before. It is shown in Mendelssohn and Sobel (1977) that the solution of (3.1) is of the form:

$$\bar{\delta}_t = \text{minimum} \{x_t, y^*\}$$

where $0 \leq y^* \leq y_{\max}$.

As an example of the difference between these two policies, consider the following model for salmon in the Wood River postulated by Mathews (1967):

$$x_{t+1} = (e^d) 4.077 y_t \exp\{-0.800 y_t\}$$

where d is distributed as $N(0, 0.2098)$. Solved on a 51 point grid, $y^* = 0.700$ (Mendelssohn 1978b) when $\alpha = 0.97$. On this same grid, $y_{\max} = 1.26$ which is close to the true y_{\max} of 1.25 (the grid points are in units of 10^6 fish).

Two measures of interest will be examined. The first is the mean per period harvest under the two policies. The second is the long-run probability of being in any state.^{1/} Following $\{\delta_t^*\}$ yields a mean per

ϕ
Lower case
phi

^{1/}This is the vector ϕ , where $\phi(x) = \sum_{j \in X} \phi(j) P_{jx}^\pi$.

period harvest of 0.916727×10^6 fish, following $\{\bar{\delta}_t\}$ yields a mean per period harvest of 1.188993×10^6 fish.

Table 3.1 shows the distribution function of the stationary probabilities arising from the two policies. The policy $\bar{\delta}$ which maximizes the long-run expected harvest has a greater average harvest compared with δ^* of 272,263 fish, and with a lower variance between harvest amounts. $\bar{\delta}$ also has a zero harvest only 3.28% of the years, while the minimum risk policy δ^* does not harvest 19.67% of the time.

Conversely, the minimum risk policy almost halves the probability of being in the low population sizes of 420,000-840,000 fish, from 7.4% of the time to 4.1% of the time.

Table 3.1 here

It is clear that these two policies are the two extremes. A natural question is how to find policies, if any exist, that greatly increase the expected total discounted harvest, at only a small increase in risk.

Theorem 3.1 can be generalized slightly by assuming that $x_{t+1} = s[y_t, D_t]$. In this model the random variable need not act multiplicatively as before.

Theorem 3.2 If, except for the zero state, every $x \in X$ can be reached with positive probability from every other $x \in X$, and (i) if there exists a δ^* such that:

$$s[\delta^*(x_1), D_1] \stackrel{ST}{\geq} s[\delta(x_1), D_1]$$

for all feasible decision rules δ and all $x_1 \in X$; then

$$\pi^* = (\delta^*, \delta^*, \dots)$$

is a stochastically dominant policy.

(ii) if no such δ^* exists, then there does not exist a policy that is stochastically dominant.

□

The advantage of theorem 3.2 is that only a one-period problem need be solved. Either that solution is the long-term solution also, or if no solution exists for this "static" problem, then no solution exists for the larger problem.

I have not been able to find any policies that are stochastically dominant when the criteria is (2.2b); nor have I been able to prove that such a policy doesn't exist. However, I conjecture the following:

Conjecture 3.1 There is no policy π^* , such that the Markov chain of the amount harvested following π^* , $\{z_n^{\pi^*}, n \in N_0\}$, compared with the Markov chain $\{z_n^{\pi}, n \in N_0\}$ that arises from following policy π , satisfies:

$$z_n^{\pi^*} \stackrel{ST}{\geq} z_n^{\pi} \quad \text{for all } n$$

for every possible feasible π .

□

It is worth reviewing where we are. We have found a stochastically dominant policy under certain assumptions. This was found to produce a solution that greatly reduces the economic return from the harvest (in fact, if $s[\cdot]$ is nondecreasing, then theorem 3.1 states that the risk is minimized by not harvesting at all). Also, for certain other models, it has been either proven or conjectured that there does not exist a policy that minimizes the risk of an undesirable event. Finally, a numerical example has led us to speculate that a large gain in economic return can be obtained by incurring only a small increase in the risk.

IV. Pareto Optimal Policies

In most decisionmaking situations, the decisionmaker usually is faced with not one, but rather a myriad of conflicting objectives. However, intuitively we often feel that even in this situation, there is a "best" policy in the sense that this "best" policy most fairly balances the different objectives. To examine all the tradeoffs possible could be even more confusing than enlightening for the decisionmaker. It would be desirable to reduce the set of policies that need to be evaluated in examining these tradeoffs.

One such set of policies are policies that are "Pareto optimal," or more precisely, whose expected returns are Pareto optimal. If there are two objectives, Pareto optimal policies have an intuitive explanation: A policy is Pareto optimal if there is no other feasible policy that does at least as well in any one of the objectives, and strictly better in the other objective.

apital pi

To describe this more formally, let Π be the set of all possible policies; let $v^\pi = (v_1^\pi, v_2^\pi, \dots, v_k^\pi)$ be the vector value of the k objectives v_1, v_2, \dots, v_k . Let V be the set of all possible v^π for $\pi \in \Pi$. Then a policy $\pi^* \in \Pi$ is said to be Pareto optimal if there does not exist some other policy $\pi \in \Pi$ such that

$$v^\pi \geq v^{\pi^*} \quad \underline{2/}$$

2/When comparing two k -vectors $x = (x_1, \dots, x_k)$ and $y = (y_1, \dots, y_k)$, $x = y$ implies $x_i = y_i, i = 1, \dots, k$; $x \geq y$ implies $x_i \geq y_i, i = 1, \dots, k$; $x \leq y$ implies $x \geq y$ but $x \neq y$; and $x > y$ implies $x_i > y_i, i = 1, \dots, k$.

For the problems of this section, we will restrict Π to the class of stationary policies, that is policies that follow the same one-period decision rule in each period. There is a body of literature that shows that for our models, when maximizing economic return over a very long planning horizon, this is without loss of generality.

In section III, we were concerned with a class of problem that can be viewed as a multiobjective problem: Any policy is evaluated in terms of the expected (discounted) value of the harvest from that policy; it is also evaluated in terms of the degree of long-run risk of an undesirable event that occurs from following this policy. Our goal now is to find the class of Pareto optimal policies between these two objectives, and to find the tradeoff curve on this set of policies, rather than trying to strictly optimize.

To accomplish this, assume problem (3.1) has been discretized on a set of states $X_1 = (x_1, x_2, \dots, x_k)$ and a set of feasible decisions from each $x \in X$, is given by $Y(x) = \{y | 0 \leq y \leq x; y \in X\}$. If it is desired to maximize the long-run average harvest, or more formally:

$$E \left\{ \lim_{T \rightarrow \infty} \left(\frac{1}{T} \right) \left[\sum_{t=1}^T (x_t - y_t) \right] \right\}$$

subject to the transition and harvest constraints, then this is equivalent to solving the following linear programming problem (DeGhellinck 1960; Manne 1960):

$$\begin{aligned} & \text{maximize } \sum_{x \in X_1} \sum_{y \in Y(x)} u_x^y G_y^x \\ & \text{s.t. } \sum_{y \in Y(x)} u_x^y - \sum_{j \in X_1} \sum_{y \in Y(j)} u_j^y p_{jx}^y = 0 \quad x \in \{x_1/1\} \quad (4.1) \end{aligned}$$

$$\sum_{x \in X_1} \sum_{y \in Y(x)} u_x^y = 1$$

$$u_x^y \geq 0 \quad \text{for all } x \in X_1, y \in Y(x)$$

where G_y^x is the one-period return of observing x and harvesting to y , p_{jx}^y is the probability of going from state j to state x when action y is taken, and $\{x_1/1\}$ implies the set of state X_1 less some arbitrary base state. That is, if there are k states, there will be $k-1$ of these constraints.

At an optimal solution, $\bar{u}_x^y > 0$ if and only if choosing action y from state x is an optimal decision. Also, the optimal variables \bar{u}_x^y have the interpretation of the probability of being in state x and taking decision y . Suppose it is desired to limit the long-run probability that the process is in states contained in some subset X_2 of X_1 . This can be included into (4.1) by amending the following constraint:

$$\sum_{x \in X_2} \sum_{y \in Y(x)} u_x^y \leq \omega \quad (4.2)$$

Similarly, if it is desired to limit the probability that the harvest is less than a given amount, let Z_1 be the set of (x, y) pairs that harvest the fixed amount or less. Then amend the constraint:

$$\sum_{(x, y) \in Z_1} u_x^y \leq \eta \quad (4.3)$$

The advantage of this approach is that linear programming allows for parametric analysis of the right-hand sides of the constraints. Thus, it is simple to start off with ω (resp. η) equal to one, that is the unconstrained or maximum average return problem, and parameterize it to zero, or the minimum long-run risk problem.

If instead it is desired to maximize the expected total discounted return, then again, after discretizing the problem, a solution can be found by solving the following linear programming problem (d'Epenoux 1963)

Three caveats should be noted carefully. It is always advisable to initially have ω or η identically one and parameterize to zero. This is because at zero, the problem may be infeasible, that is no policy can achieve this constraint. To parameterize an LP solution, it is necessary to have an initial feasible solution.

Secondly, a randomized policy may become optimal. A randomized policy is a policy that instead of choosing only one action from each state, chooses one out of several actions from each state by a "lottery" with a given distribution. While this is of some theoretic importance, most policy makers today, would not recommend that we manage our resources by tossing dice. However, if only one constraint is amended to (4.2) then Kushner (1971) shows that at most one state will have a randomized decision, and this will involve a "lottery" between at most two actions feasible from that state.

Thirdly, Mendelsohn (1978a) has shown that the size of the grid chosen and the procedure used to discretize the original problem can greatly affect the final values of \bar{u}_x^y for a given problem, as well as the estimates of the stationary distribution $\phi(x)$. Numerical experiments in that paper show that the choice of grid can increase our estimated risk by three to five times. Thus it is possible to artificially create a critical tradeoff which does not exist in the original, continuous state space problem

V. Numerical Examples

To see how these techniques work in practice, consider again the model developed by Mathews (1967) for salmon runs in the Wood River:

$$x_{t+1} = (e^d) 4.077 y_t \exp \{-0.800 y_t\}$$

where d is distributed as $N(0, 0.6768)$.

This is discretized on the following 16 point grid

$$X_1 = (0, 0.467, 0.933, 1.400, 1.867, 2.333, 2.800, 3.267, 4.200, \\ 4.667, 5.133, 5.600, 6.067, 6.533, 7.000)$$

in units of 10^6 fish. Numerical experiments suggest that for real stability in terms of caveat three a 51 point grid should be used. However, this 16 point grid produces an LP with 136 variables and 17 constraints; the 51 point grid produces an LP with 1,326 variables and 52 constraints a very large problem for illustrative purposes. For management purposes, the larger grid size should be used. The return function of interest is (3.1), and (4.4) rather than (4.1) is analyzed. The reason is that while on a 51 point grid, the optimal policy never goes to state zero, it is easy to demonstrate that on the 16 point grid every policy ultimately is absorbed in the zero state. The discounted problem therefore takes into consideration shorter-run behavior, or conversely, the time to absorption.

The optimal policy for (3.1) for this problem is a base stock policy given by:

$$y_t = \text{minimum} \{x_t, 0.933\}$$

The following constraints were added to (4.4), one at a time:

$$(i) X_2 = \{x \in X_1 : x \leq 0.467\} ; v_x = 1 \quad \text{for all } x \in X$$

$$\sum_{x \in X_2} \sum_{y \in Y(x)} \frac{0.03}{16} u_x^y \leq \omega$$

$$(ii) X_2 = \{x \in X_1 : x \leq 0.467\} ; v_0 = 0 ; v_x = 1/15 \text{ otherwise}$$

$$\sum_{x \in X_2} \sum_{y \in Y(x)} (0.03) u_x^y \leq \omega$$

$$(iii) X_2 = \{x \in X_1 : x \leq 0.933\} ; v_x = 1 \quad \text{for all } x \in X$$

$$\sum_{x \in X_2} \sum_{y \in Y(x)} \frac{0.03}{16} u_x^y \leq \omega$$

$$(iv) Z_1 = \{(x, y) : x - y \leq 0.467\} ; v_0 = 0, v_x = 1/15 \text{ otherwise}$$

$$\sum_{(x, y) \in Z_1} (0.03) u_x^y \leq \eta$$

The results are summarized in Table 5.1(a)-(d). For population based probabilistic constraints, an optimal policy moves from a base stock policy of 0.933 to a base stock policy of 1.400, which on the 16 point grid is the optimal minimum risk policy. While any of the intermediate policies could be implemented, the shift between the two base stock sizes does not occur in any monotone fashion, that is first all the larger (or smaller) stock sizes switch their policy, and then the other subset of states are switched over. This feature would make an intermediate policy easier to implement, but does not occur.

The fourth column in Table 5.1 $(1-\alpha)/\sum_1 v_i \cdot (\text{value})$ is in a sense the "discounted mean" value of the harvest. If \bar{u}_x^y is the discounted fraction of years that state x is observed and action y is taken, and if G_x^y is the one-period return, then the fourth column is equivalent to:

$$\sum_{x \in X} \sum_{y \in Y(x)} \bar{u}_x^y G_x^y$$

which is the one-period returns averaged over the discounted fraction of years it occurs. Hence, it is a "discounted mean" harvest (or value of the value). Columns 1 and 4 of Table 5.1 provide the information needed by the decisionmaker to determine the best tradeoff between risk and return.

Table 5.1 here

For the harvest based probability constraints, an optimal policy is randomized for all alternative policies except for the original base stock policy of 0.933 and the final policy. The final policy is of some interest. Summarized it is:

<u>States</u>	<u>Harvest to</u>	<u>Harvest amount</u>
0	0	0
0.467	0.467	0
0.933	0.933	0
1.400	0.467	0.933
1.867	0.933	0.933
>1.867	1.400	x - 1.400

This policy is very similar to an optimal policy that arises when "smoothing costs" (costs on the amount of year to year fluctuations in the allowed harvest) are added to the problem, with a positive cost only for decreasing the harvest (Mendelssohn 1978b). This suggests that smoothing costs act like a probabilistic constraint, most likely constraining the variance (or discounted variance) of the fraction of periods a state-action combination occurs.

Also, since randomized policies do not seem to occur in population based constraints, but do occur in harvesting based constraints, leads to the following conjecture: If for every state that has at least one action included in a probabilistic constraint, all actions are also included in the probabilistic constraint, then a non-randomized policy will be optimal. Otherwise, a randomized policy will be optimal whenever the probabilistic constraint is binding, except perhaps at the two extreme points.

A proof of the conjecture has not been found. But trying to find such rules are important. They lend the analyst insight into how to set up a problem both so as to obtain the desired tradeoffs and to obtain policies that can be implemented. And ultimately, the purpose of all model building is the added insight they give to people who make the final decisions.

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Appendix

A lemma is needed before the theorems can be proven. Lemma 1 is a specialized version of theorem 3 in O'Brien (1975). The proof can be found in O'Brien (1975).

Lemma 1. Let $\{x_n, n \in N_0\}$ and $\{y_n, n \in N_0\}$ be two real-valued, discrete time Markov processes. If:

$$(i) \overset{ST.}{x_0} \leq y_0$$

$$(ii) \Pr \{x_{n+1} \geq t | x_n = x\} \leq \Pr \{y_{n+1} \geq t | y_n = y\}$$

for all t, n , and $x \leq y$

then:

there exists two new processes $\{\tilde{x}_n\}$ and $\{\tilde{y}_n\}$ such that on a common probability space Ω

- (a) \tilde{x}_n is distributed as x_n for all n
- (b) \tilde{y}_n is distributed as y_n for all n
- (c) $\tilde{x}_n(\omega) \leq y_n(\omega)$, for all n , and all $\omega \in \Omega$

□

Proof of theorem 3.1: For any x_1 , the policy

$$y_1 = \min\{y_{\max}, x_1\}$$

can be shown to be stochastically dominant as follows. Let δ^* be this decision rule, and δ any other one-period decision rule. Then:

$$\Pr\{x_2 \leq \omega | x_1, \delta\} = \Pr\{D s[\delta(x_1)] \leq \omega\} = \Pr\left\{D \leq \frac{\omega}{s[\delta(x_1)]}\right\}.$$

Since on the set $\{y : 0 \leq y \leq x_1\}$, $s[\delta^*(x_1)] \geq s[\delta(x_1)]$, then:

$$\frac{\omega}{s[\delta^*(x_1)]} \leq \frac{\omega}{s[\delta(x_1)]}$$

or that δ^* is stochastically dominant over δ . This implies part (i) of lemma 1.

Conditioned on x_t , the policy

$$y_t = \min\{y_{\max}, x_t\} = \delta^*$$

compared to any other one-period decision rule δ can be shown to satisfy:

$$\Pr\{x_{t+1} \geq \omega | x_t, \delta^*\} \geq \Pr\{x_{t+1} \geq \omega | x_t, \delta\}$$

by the same argument as above. This is part (ii) of lemma 1, and hence the theorem is proven.

□

Proof of theorem 3.2. Part (i): By assumption, π^* is stochastically dominant for x_2 given any x_1 . This is condition (i) of lemma 1.

Suppose for some $x_t^1 \leq x_t^2$, $x_t^1, x_t^2 \in X$, there exists a decision rule δ part of policy π , such that:

$$\Pr\{s[\delta(x_t^1), D_t] \geq \omega\} > \Pr\{s[\delta^*(x_t^2), D_t] \geq \omega\} \text{ for some } \omega \in \Omega.$$

Since the D_t 's are i.i.d. random variables, this would imply:

$$\Pr\{s[\delta(x_1^1), D_1] \geq \omega\} > \Pr\{s[\delta^*(x_1^2), D_1] \geq \omega\} \text{ for some } \omega \in \Omega.$$

However, this contradicts the assumption of the theorem that δ^* is a stochastically dominant decision rule for x_2 given x_1 . This contradiction implies condition (ii) of lemma 1.

Part (ii): The proof is by contradiction. Suppose a stochastically dominant policy exists, say $\pi^* = \{\delta_1^*, \delta_2^*, \dots\}$, but no one-period decision rule δ^* exists that is stochastically dominant. By assumption, any state except perhaps the absorbing state is reached with positive probability. Then, conditioned on x_t , there is no policy that is stochastically dominant for x_{t+1} , since by assumption δ^* does not exist, and the transition probabilities are stationary. This contradicts condition (ii) of lemma 1; from the proof of theorem 3 in O'Brien it is evident that this is sufficient to disprove that the chain resulting from π^* is stochastically dominant.

□

Table 3.1 Cumulative stationary probability of the two policies.

State	$\Pr\{x \leq x \delta^*\}$	$\Pr\{x \leq x \bar{\delta}\}$
0.000	0.0000	0.000
0.140	0.0000	0.000
0.280	0.0000	0.0001
0.420	0.0006	0.0016
0.560	0.0044	0.0100
0.700	0.0164	0.0328
0.840	0.0412	0.0744
0.980	0.0806	0.1340
1.120	0.1335	0.2072
1.260	0.1967	0.2880
1.400	0.2664	0.3710
1.540	0.3387	0.4518
1.680	0.4105	0.5274
1.820	0.4794	0.5962
1.960	0.5438	0.6574
2.100	0.6027	0.7109
2.240	0.6558	0.7571
2.380	0.7031	0.7966
2.520	0.7447	0.8301
2.660	0.7811	0.8583
2.800	0.8127	0.8820
2.940	0.8400	0.9018
3.080	0.8635	0.9183
3.220	0.8836	0.9320
3.360	0.9008	0.9434
3.500	0.9155	0.9529

Table 3.1 (Continued).

State	$\Pr\{x \leq x \delta^*\}$	$\Pr\{x \leq x \bar{\delta}\}$
3.640	0.9280	0.9608
3.780	0.9387	0.9673
3.920	0.9478	0.9727
4.060	0.9555	0.9772
4.200	0.9621	0.9810
4.340	0.9677	0.9841
4.480	0.9724	0.9867
4.620	0.9764	0.9889
4.760	0.9798	0.9907
4.900	0.9827	0.9922
5.040	0.9852	0.9935
5.180	0.9873	0.9946
5.320	0.9891	0.9955
5.460	0.9907	0.9963
5.600	0.9920	0.9969
5.740	0.9931	0.9974
5.880	0.9941	0.9978
6.020	0.9949	0.9982
6.160	0.9956	0.9985
6.300	0.9962	0.9988
6.440	0.9967	0.9990
6.580	0.9972	0.9992
6.720	0.9976	0.9994
6.860	0.9979	0.9995
7.000	1.0000	1.0000
Mean harvest	0.916727	1.18899
Variance of harvest	0.89423	0.7874

Table 5.1(a). Bounds on discounted fraction of years $x_t \leq 0.467$.

Total fraction of years, ω	Change in policy		Value	$\frac{(1-\alpha)}{\sum_i v(i)}$ (value)
	State	Action		
0.08836	Base stock at	0.933	656.721	1.2314
0.08836	1.867	1.400	656.721	1.2314
0.08735	6.533	1.400	611.634	1.1468
0.08733	3.267	1.400	610.725	1.1451
0.08702	4.667	1.400	596.745	1.1189
0.08696	1.400	1.400	593.696	1.1132
0.08608	4.200	1.400	554.016	1.0401
0.08596	2.333	1.400	548.917	1.0292
0.08518	2.800	1.400	513.729	0.9632
0.08466	7.000	1.400	490.039	0.9188
0.08464	3.733	1.400	489.073	0.9170
0.08444	5.133	1.400	480.126	0.9002
0.08439	6.533	1.400	478.026	0.8963
0.08437	5.600	1.400	477.267	0.8949
0.08434	No change		475.864	
<0.08434	Infeasible			

Initial distribution $v(i) = 1$ for all states i

Table 5.1(b). Bounds on discounted fraction of years $x_t \leq 0.467$.

Total fraction of years, ω	Change in policy		Value	$\frac{(1-\alpha)}{\sum_i v(i)}$ (value)
	State	Action		
0.02758	Base stock at	0.933	43.7814	
0.02758	1.867	1.400	43.7814	
0.02651	6.067	1.400	40.7756	
0.02349	3.267	1.400	40.7150	
0.02616	4.667	1.400	39.7830	
0.02609	1.400	1.400	39.5797	
0.02515	4.200	1.400	36.9344	
0.02503	2.333	1.400	36.5945	
0.02415	7.000	1.400	34.2486	
0.02417	2.800	1.400	34.1856	
0.02361	3.733	1.400	32.6049	
0.02340	5.133	1.400	32.0084	
0.02335	6.533	1.400	31.8684	
0.02333	5.600	1.400	31.8178	
0.02330	No change		31.7243	
<0.02330	Infeasible			

Initial distribution: $v(0) = 0$, $v(i) = 0.066667$, $i \neq 0$

Table 5.1(c). Bounds on discounted fraction of years $x_t \leq 0.933$.

Total fraction of years, ω	Change in policy		Value	$\frac{(1-\alpha)}{\sum_i v(i)}$ (value)
	State	New action		
0.15580	Base stock at	0.933	656.721	1.2314
0.15580	1.867	1.400	656.721	1.2314
0.15299	3.267	1.400	611.634	1.1468
0.15212	6.067	1.400	597.667	1.1206
0.15206	4.667	1.400	596.745	1.1189
0.15187	1.400	1.400	593.696	1.1132
0.15041	4.200	1.400	554.016	1.0388
0.14909	2.333	1.400	548.917	1.0292
0.14690	2.800	1.400	513.729	0.9632
0.14543	3.733	1.400	490.039	0.9188
0.14487	5.133	1.400	481.101	0.9021
0.14474	7.000	1.400	479.004	0.8981
0.14468	5.600	1.400	478.026	0.8963
0.14466	6.533	1.400	476.623	0.8937
0.14455	No change		475.864	
<0.14455	Infeasible			
Initial distribution $v(i) \equiv 1$		for all states i		

Table 5.1(d). Bounds on discounted fraction of years $z_t \leq 0.467$.

Total fraction of years, ω	Change in policy		Value	$\frac{(1-\alpha)}{\sum_i v(i)}$ (value)
	State	Action		
0.30498	Base stock at	0.933	43.78143	1.3134
0.25000	1.400	Randomized between 0.467, 0.933	42.98377	1.2900
0.16647	1.400 3.267	0.467 Randomized: 1.400, 0.933	41.7717	1.2532
0.16549	3.267 6.067	1.400 Randomized: 1.400, 0.933	41.0265	1.2308
0.16542	6.067 4.667	1.400 Randomized: 1.400, 0.933	40.9748	1.2292
0.16521	4.667 2.333	1.400 Randomized: 1.400, 0.933	40.8160	1.2245
0.16251	4.667 4.200	1.400 Randomized: 1.400, 0.933	38.7655	1.1630
0.16216	4.200 2.800	1.400 Randomized: 1.400, 0.933	38.4950	1.1549
0.16043	2.800 7.000	1.400 Randomized: 1.400, 0.933	37.1798	1.1154
0.16036	7.000 3.733	1.400 Randomized: 1.400, 0.933	37.1263	1.1138
0.15974	3.733 5.133	1.400 Randomized: 1.400, 0.933	36.6561	1.0997
0.15960	5.133 6.533	1.400 Randomized: 1.400, 0.933	36.5452	1.0964
0.15954	6.533 5.600	1.400 Randomized: 1.400, 0.933	36.5010	1.0950
0.15944	5.600	1.400	36.42505	1.0928
<0.15944	Infeasible			

Initial distribution: $v(0) = 0$, $v(i) = 0.066667$