The Estimation of the Elasticity of the Production Factors of the Mining Sector of Iran

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ABSTRACT

One of the most important mineral producers in the world is Iran. In order to do the research, first, the annual time series data is collected from the website of Central Bank and Statistics Center of Iran. This paper determines the elasticity of the production factors of labor and capital for mining sector in Iran covering data 1988 to 2010. The Cobb-Douglas function is used to estimate mining sector production function which it involves OLS method using EVIEWS8 and SPSS software. According to the results of this study during the years of the study the coefficients of the natural logarithm of the real capital and the natural logarithm of the labor in Iran are 1.621488 and 2.962340, respectively and these coefficients are statistically significant at the 5% confidence level. Indeed, these coefficients show the amount of elasticity of production factors for the mining sector in Iran. Hence, if the capital in the mining sector increases one percentage then the production in this sector increases 1.621488 and while the labor in this sector increases one percentage, then the production in this sector increases 2.962340 percent.

KEY WORDS: Cobb-Douglas Function, Value Added, Mining Sector, Production Function, Elasticity and Iran.

INTRODUCTION

Mineral resources and sources under the earth is one of the most important economics bases in each country. The importance of mining and sources in the economic growth of countries is undeniable. One of the most important mineral producers in the world is Iran. But unfortunately, its production is underdevelopment. More than 7% of the world's total mineral is located in Iran whereas its population is roughly 1% of the world's population. There are 68 types of minerals in Iran. Its actual and potential reserves of this country are about 37 and 57 billion tones, respectively. The most important mines in Iran are sand, metallic minerals, coal, and gravel, chemical minerals and salt. The most operating mines in Iran concerns Khorasan province, [8, 29, 30 and 31, 43, 49 and 50]. In the following figure is shown the proportion of the mining value add to the GDP in Iran at the period of this research, [49 and 50].

As we can see, the proportion of the mining value added has increased the period of the study in Iran. And this represents that importance of mining sector in the Iran economic. This ratio has been less than 0.5 percent in 1988.
and it has gone up next to one percent in 2010. The capital stocks of the mining sector show at the following graph in the times series of the research, other papers on this subject include [32-41].

As we can see in the figure 2, the capital stocks of the mining sector in Iran have increased period of the study years. One of the most important things in production function is the ratio of capital stock respect to labor. The paper has been calculated this ratio for the mining sector of Iran. And it has shown graphically as follows, [49 and 50]:

The above figure shows, gradually, the production technology of the Iranian mining sector has changed towards using of more than capital from using labor.

As we know, elasticity is one of the most important and empirical concepts. In fact, elasticity is the ratio of percentage changing of two variables. On the other hand, the elasticity indicates for each one percent changing in the independent variable, the changing percentage of dependent variable will be. For example, if the elasticity x and y, exy, is 2 when a one percent increase in x causes a 2 percent increase in y. If Y = f(x), then the elasticity, e_xy, can be shown by following equation:

\[ e = \frac{\% \Delta Y}{\% \Delta x} \quad \text{Or} \quad e = \frac{\Delta y / \Delta x}{y / x} \]

Many papers in economic to analyze companies behaviors assumes that production functions of companies are in form of the Cobb-Douglas production function which first introduced by Charles Cobb and Paul Douglas [3,5,6 and 9]. It is written as follow:

\[ Q = F(L,K) = A L^{a_1} K^{a_2} \]

Where, A, α_1 and α_2 are parameters. In this function, α_1 and α_2 show the production elasticity of labor and capital, respectively. In this form, the marginal product of labor can be estimated as the following equation [1, 2 and 4]:
And the marginal product of capital is obtained as follow:

\[ MP_L = \alpha_1 AL^{\alpha_1-1}K^{\alpha_2} \]

Hence, the marginal rate of technical substitution between labor and capital, \( \text{MRTS}_{LK} \), is:

\[ \text{MRTS}_{LK} = \left( \frac{\alpha_1}{\alpha_2} \right) \left( \frac{K}{L} \right) \]

The main objective of this paper is to estimate the production function in the Iran mining sector. Determination of this function will help the Iran mining decision makers to take a good decision to reduce extra costs and increase productivity in this sector.

The main hypotheses in the study are as follow:
1. The labor elasticity in mining sector of Iran is statistically significant and positive during period 1988 to 2009.
2. The capital elasticity in mining sector of Iran is statistically significant and positive during period 1988 to 2009.

**MATERIALS AND METHODS**

The paper applies the descriptive and analytical methods. Achieving the aim theoretical discussions and empirical studies was conducted using library methods. The required data, the related background information on empirical studiers and literature was collected by internet and library ways. The statistical data are taken from statistical data of Central Bank and the Statistical Center of Iran. After collecting the secondary data, it is necessary to determine to be or not to be the stationary for the data. Unit root test of Augmented Dickey-Fuller (ADF) is applied for it. Then is used the Cobb-Douglas function representing the relationship between the mining sector value add of Iran as a dependent variable and its factors of production, labor and capital, as the independents variables, other papers on this subject include [12- 28 and 44-48].

To representing the model is used the Cobb-Douglas function as the following:

\[ Q = F(L,K) = AK^{1-1}\alpha_1 L^{\alpha_2} \]

Now, the paper takes the natural logarithm from two sides of above equation, so we can easily the following liner function:

\[ \ln(Q) = \ln(A) + \alpha_1 \ln(K_{i,i}) + \alpha_2 \ln(L) \]

Where

\( A = \) as a constant amount

\( \ln(Q) = \) the natural logarithm of the mining sector value added of Iran

\( \ln(K_{i,i}) = \) the natural logarithm of the capital stock in the mining sector in Iran with one lag period.

\( \ln(L) = \) the natural logarithm of the number of employees in the mining sector in Iran.

Hence, the linear regression model can be used to estimate the production function in this research. The statistical population limits to Iran economy. The studied variables in this study are annual time series data mainly from 1988 to 2010. The study applies EIEWS8 and SPSS Software. Then significant of the model and coefficients investigates using appropriate statistical analyzes.

**RESULTS AND DISCUSSION**

Due to the results of the ADF test, at 5% confidence level, all of the data are not stationary at the level but only the natural logarithm of the mining sector value added of is stationary at the first difference level and the other variables in the natural logarithm of the variables are stationary at the second difference. In other words, however the variables have unit root test at the level but have not unit root test at the first difference for the Q and the L and second difference for the \( K_{i,i} \), while the natural logarithm of the variables are used in the Cobb Douglas function [7 and 10].

The ADF test results are as come at the following table:

<table>
<thead>
<tr>
<th>The names of variables</th>
<th>ADF statistics</th>
<th>The Critical Value at 5%</th>
<th>The Stationary at</th>
<th>Prob.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ln(Q)</td>
<td>-5.523267</td>
<td>-3.644963</td>
<td>1st difference</td>
<td>0.0012</td>
</tr>
<tr>
<td>Ln(K_{i,i})</td>
<td>-5.147565</td>
<td>-3.658446</td>
<td>2st difference</td>
<td>0.0028</td>
</tr>
<tr>
<td>Ln(L)</td>
<td>-8.588226</td>
<td>-3.673616</td>
<td>2st difference</td>
<td>0.0000</td>
</tr>
</tbody>
</table>
In order to estimate the relationship among the mining sector value added of Iran and the effective’s variables, the L and K, are applied the linear regression model. The function coefficients can be found from the below table [42 and 43]:

### Table 2. Coefficients of Model

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>Std. Error</th>
<th>t-Statistic</th>
<th>Prob.</th>
</tr>
</thead>
<tbody>
<tr>
<td>C</td>
<td>-24.84971</td>
<td>4.918796</td>
<td>-5.051991</td>
<td>0.0001</td>
</tr>
<tr>
<td>LN K$_{t-1}$</td>
<td>1.621488</td>
<td>0.590941</td>
<td>2.743910</td>
<td>0.0129</td>
</tr>
<tr>
<td>LNL</td>
<td>2.962340</td>
<td>0.450918</td>
<td>6.569568</td>
<td>0.0000</td>
</tr>
</tbody>
</table>

The results of the study show, in the model, the coefficients of the natural logarithm of the capital stock in the mining sector with one lag period and the natural logarithm of the number of employees in the mining sector in Iran are 1.621488 and 2.962340, respectively. Due to the information of above table, all of coefficients are significant at %5 confidence level. In fact, these coefficients show the amount of elasticity of production factors for the mining sector in Iran. Hence, if the capital in the mining sector increases one percentage then the production in this sector increases 1.621488 and while the labor in this sector increases one percentage, then the production in this sector increases 2.962340 percent.

The coefficients of the variables are also statistically significant due to ANOVA test (see the ANOVA table as the follow):

### Table 3. ANOVA

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Regression</td>
<td>3.856</td>
<td>2</td>
<td>1.928</td>
<td>29.352</td>
</tr>
<tr>
<td></td>
<td>Residual</td>
<td>1.248</td>
<td>19</td>
<td>.066</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>5.104</td>
<td>21</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a. Dependent Variable: lnQ

The results of the paper show that one percent change in capital causes to change 1.621488 percent in the production of the mining sector and one percent change in the labor causes to change 2.962340 percent in the production.
other words, the elasticity of capital and labor are 1.621488 and 2.962340, respectively. Hence, it is important to invest in the mining sector in Iran.

Conclusions

This study estimates the factors elasticity of production in the mining sector of Iran using the Cobb Douglas function in Iran during 1988 to 2110. This survey examines the changes in the production factors how much affect on the change in the mining sector value added in Iran. The results of the study show that increasing capital or labor in the mining sector causes to increase the mining sector value added.

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