



UNIVERSITY OF MACAU

FACULTY OF SOCIAL SCIENCES AND HUMANITIES

DEPARTMENT OF ECONOMICS

**Modeling Static and Intertemporal Import Demands:
The Indirect Production Function Approach**

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A thesis submitted in partial fulfillment of the requirements for the degree
of Master of Social Sciences at the University of Macau.

August 2012

Abstract

Abstract of thesis entitled “Modeling static and intertemporal import demands: The Indirect Production Function Approach”, submitted by Mao Dongdong (M-B0-5631-1) for the degree of master of Social Science in Economics at the University of Macau in August 2012.

Recently, international trade becomes an important part of the world economy. Every country needs raw materials from other countries to produce intermediate and final goods that are needed. The objectives of dissertation are therefore two-fold. First, the static import demand system is presented and estimated by employing Deaton & Muelbauer’s (1980) Almost Ideal Demand System (AIDS). The indirect production function is applied to generate this system. Because of the limitations of static analysis, the second objective is to incorporate intertemporal production behavior as summarized by the Euler equation. The input demand system and the Euler equation constitute a system of recursive equations with cross-equation parameter restrictions, which require the jointly estimation of the input demand system and the Euler equation. More importantly, these systems are estimated by a careful implementation of the orthogonality conditions using generalized method of moments. The input demand systems are illustrated with an application to Australian quarterly data.

Results indicate that the proposed methods are operational. The signs and size of the estimated Marshallian, Morishima elasticity of substitution, intertemporal elasticity of substitution and Frisch price elasticities are found to be sensible, and capital and imports are found to be substitution, which is inconsistent with the findings in earlier studies.

Keywords: Import Demands; The Almost Ideal Demand System; Intertemporal Two-Stage Budgeting; The Euler Equation



Declaration

I declare that this thesis represents my own work, except where due acknowledgement is made, and that it has not been previously included in a thesis, dissertation or report submitted to this University or to any other institution for a degree, diploma or other qualification.

Signed _____



Acknowledgments

It is my great pleasure to express my sincere gratitude to the people who have spent their effort and patience to assist me to finish my thesis. Without their help, my life at University of Macau will not be so memorable.

First of all, I would like to express my greatest gratitude to my supervisor, Prof. K. K. G. Wong. As an instructor of my master courses, he provided clear and effective guidance on his course, and helped me a lot during my thesis writing process. He also demonstrated an endless patience and helpful supervision during the process of writing thesis. I am so glad to be supervision by him.

I am grateful to my thesis examination committee members, Prof. W.H. Ho and Dr. V. Dang. In addition, my thanks go to Prof. Y. Kim from the Western Kentucky University, who kindly responded to my questions about some difficult concepts.

Sincere appreciation also goes to the instructors in the Department of Economics. The excellent instructions extend and deepen my knowledge on Economics and Finance. Special thanks go to Dr. H. C. Chang and Dr. P. Porapakkarm, for their kind concerns and encouragement on many issues.

My gratitude also delivers to the University of Macau and the Department of Economics for offering me many opportunities to participate in various activities, which make my life more fruitful.

Last but not least, I'd like to thank my family, for their profound support and love. My thankfulness should also extend to my classmates and friends, for their friendly help and constant encouragement.



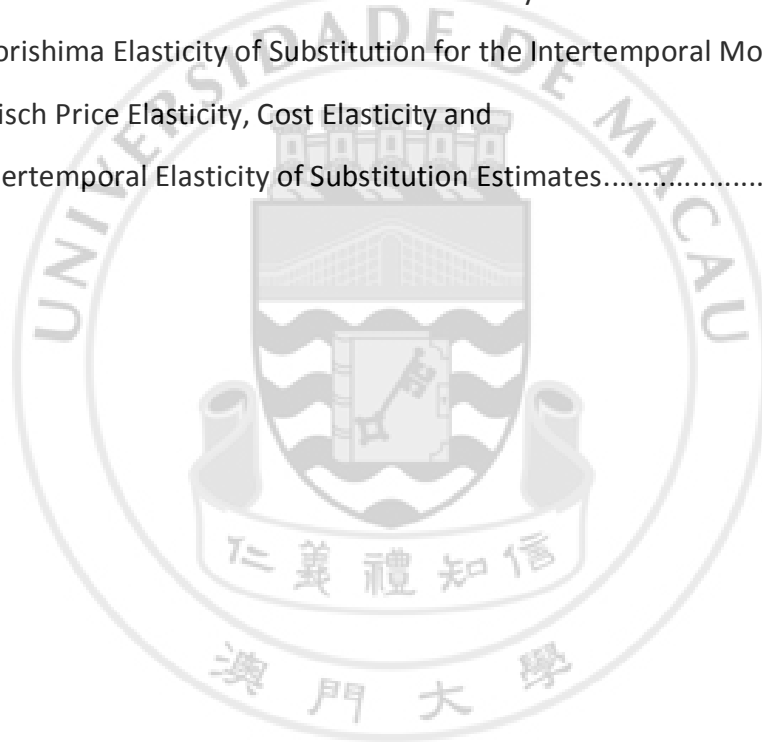
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Notation

The following are the lists of principal notations used through this dissertation. The notation is also described on its first occurrence in subsequent chapters. Notation which is not be used comprehensively will be explained in the text.

Chapter 2

Notation	Description
$\mathbf{x} = (x_1, \dots, x_n)^T$	a vector of input quantities
$\mathbf{p} = (p_1, \dots, p_n)^T$	a vector of input prices
$c = \mathbf{p}^T \mathbf{x}$	the total cost of production
y	the output quantity
$Y(\mathbf{x})$	the direct production function
$\tilde{Y}(\mathbf{p}, c)$	the indirect production function
$C(\mathbf{p}, y)$	the cost function
$X_i^M(\mathbf{p}, c)$	the Marshallian input demand function
$\mathbf{s} = (p_1/c, \dots, p_n/c)^T$	the normalized input price vector
$X_i^H(\mathbf{p}, y)$	the Hicksian input demand function
$W_i^M(\mathbf{p}, c)$	the Marshallian input demand function in cost share form
λ_t	the marginal product of cost in period t
$M_{ij} = \frac{\partial \log X_i^M}{\partial \log p_j}$	the Marshallian price elasticity

$MES_{ij} = \frac{\partial \log (C_i(\mathbf{p}, y)/C_j(\mathbf{p}, y))}{\partial \log (p_j/p_i)}$	the Morishima elasticity of substitution
$F_{ijt} = \left. \frac{\partial \log X_{it}^M}{\partial \log p_{jt}} \right _{\lambda_t}$	the Frisch price elasticity
$IES == \frac{\partial \log (c_t)}{\partial \log \lambda_t^{-1}}$	the intertemporal elasticity of substitution

Chapter 3

Notation	Description
$\mathbf{x} = (x_1, \dots, x_n)^T$	a vector of input quantities
$\mathbf{p} = (p_1, \dots, p_n)^T$	a vector of input prices
$c = \mathbf{p}^T \mathbf{x}$	the total cost of production
$\tilde{Y}(\mathbf{p}, c)$	the indirect production function
$C(\mathbf{p}, y)$	the cost function
$X_i^M(\mathbf{p}, c)$	the Marshallian input demand function
w_i	the cost share of input i
$W_i^M(\mathbf{p}, c)$	the Marshallian input demand function in cost share form
λ_t	the marginal product of cost in period t
$M_{ij} = \frac{\partial \log X_i^M}{\partial \log p_j}$	the Marshallian price elasticity
$MES_{ij} = \frac{\partial \log (C_i(\mathbf{p}, y)/C_j(\mathbf{p}, y))}{\partial \log (p_j/p_i)}$	the Morishima elasticity of substitution
$F_{ijt} = \left. \frac{\partial \log X_{it}^M}{\partial \log p_{jt}} \right _{\lambda_t}$	the Frisch price elasticity
$IES == \frac{\partial \log (c_t)}{\partial \log \lambda_t^{-1}}$	the intertemporal elasticity of substitution
\mathbf{w}_t	a vector of input share in period t

u_t	a vector of random disturbances
v_t	a vector of normally distributed error term
R	an $(N2 - 1) \times (N2 - 1)$ autocorrelation matrix

