

# Identifying the Luxury Commodities for the Selected Food Groups in Iran (Emphasizing on the Income Elasticity of Demand)

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DOI Link: <http://dx.doi.org/10.6007/IJARBSS/v3-i12/473>

Published Date: 23 December 2013

## Abstract

This paper examines the price and income elasticity of demand for Iranian non-durable food groups using AIDS system in the rural and urban areas during the period 1989-2007. The groups that here are evaluated include Meat, Rice, Bread, Oil, beverage and Dairy. The findings indicate that almost the commodities including Meat, Rice, beverage and Dairy have an elasticity value more than one which known as the luxury products for both urban and rural areas while this value is less than one for the bread commodity. Additionally, the rice and meat groups have the highest value for the elasticity of income.

**Keywords:** Income Elasticity of Demand, AIDS System, Food Groups .

## Introduction

There are different functions of demand such as AIDS, AL, TL, AITL and GAITL have their specific properties. In order to survey the consumer behavior in an economy, AIDS system is one of those demand functions that has been applied more than others. This pattern was presented for the first time by Muellbauer and Deaton (1980) and was named the AIDS pattern (Samadi, 2004).

There are various studies on the literature of demand function estimation in Iran and abroad. For instance, Torkamani and Azizi (2001) by measuring the AIDS demand function for the meat good in Iran. The results raised from this study indicates that the share of budget for the red meat in both urban and rural areas has been increased. Fidan and Klasra (2005) studied that quarterly effect of demand for the red and fish meat in Ankara. The findings indicate that the consumption for the meats is change in different seasons. In particularly the consumption for the Muslims in Ghorban Celebrity is raised remarkably. The paper also confirmed that the red meat is an inelastic good, but the fish meat is elastic (Ghorbani, 2010).

The consumption demand for a good is one of the important components to analyze and predict the effect of change in the consumer good price and income. This review can be

examined for the food materials. Estimation for this good can give us an appropriate perspective to adopt corresponding policies.

This study consists of three sections. The first part of the study survey the literature review on the AIDS System and the former studies in Iran and abroad. Then, we put the theoretical model in effect and according to the Statistical Center of Iran databases for some selected food groups in order to examine the luxury commodities. Eventually, giving the obtained results on the luxury commodities we recommend some policies for the respective officials.

## The Literature Review

### 1- Methodology

There are two methods to estimate the demand equations, single-equation and system equations. The demand function for the single-equation model is derived from the corresponding utility function. New systems of demand function were introduced after 1950. The Almost Ideal Demand System is one of the models.

### Almost Ideal Demand System

Considering the specific utility function is the main critic for the system equation models. *Deaton & Mullbauer* in order to solve this problem introduced the AIDS demand system which unlike the LAS and LES models doesn't follow a specific functional form. This kind of system considers the PIGLOG Expenditure function which is actually the logarithmic form of Price Independent Generalized Linear (PIGL) function. The expenditure almost is function of utility and price. Mulbur separated the utility function from the price.

The general PIGLOG form is as:

$$\text{Ln}C(U, P) = (1 - U)\text{Ln}\{a(p)\} + U\{b(p)\}$$

Where,  $U$  is utility;  $P$  is price vector.  $a$  and  $b$  are function of prices that leaner concave homogenous. Daiton and Mulbur defined these functions as:

$$\text{Lna}(P) = a_0 + \sum_{i=1}^n a_i \text{Lnp}_i + 1/2 \sum_{i=1}^n \sum_{j=1}^n \gamma_{ij} \text{Lnp}_i \text{Lnp}_j$$

$$\text{Lnb}(p) = \text{Lna}(p) + \beta_0 \prod_{i=1}^n p_i$$

Utility is zero for the poor people and it is one for the reach people. If  $U = 0$ , then  $\text{ln}a(p)$  denotes the minimum subsistence level.

$$\text{Ln}C(U, P) = a_0 + \sum_{i=1}^n a_i \text{Lnp}_i + 1/2 \sum_{i=1}^n \sum_{j=1}^n \gamma_{ij} \text{Lnp}_i \text{Lnp}_j + U\beta_0 \prod_{i=1}^n p_i^{\beta_i}$$

The terms  $a_i, \beta_i, \gamma_{ij}$  are the model parametr. The expenditure function in order to be leanr-hemofenous, the following constraints shoule be considered:

$$\sum_{i=1}^n \gamma_{ij} = \sum_{j=1}^n \gamma_{ji} = \sum_{i=1}^n \beta_i = 0, \quad \sum a_i = 1$$

The demand function is derived from the equation 3 under the Shephard's theorem as bellow:

$$q_i = \frac{\partial C(U, P)}{\partial P_i} \Rightarrow V_i = \frac{P_i q_i}{C} = \frac{\partial C(U, P)}{\partial P_i} \frac{P_i}{C} = \frac{\partial \text{Ln}C}{\partial \text{Lnp}_i} \quad (4)$$

Therefore, the share of i-th good in the household budget is equal with the partial derivative of the expenditure logarithm to the logarithm of the i-th price of good. Hence, the derivation of equation 3 to  $\ln p_i$  is as:

$$V_i = \frac{\partial \ln C}{\partial \ln p_i} = a_i + \sum_{j=1}^n \gamma_{ij} \ln p_j + \beta_i U \beta_0 \prod_{i=1}^n p_i^{\beta_i} \quad (5)$$

According to this equation, the share of each good expenditure is function of price and utility.

The total expenditure ( $M$ ) is equivalent with  $C(P,U)$  at the maximum of utility. Thus, if  $u$  is set given the  $P$  and  $M$ , then:

$$V_i = a_i + \sum_{j=1}^n \gamma_{ij} \ln p_j + \beta_i \ln(M / p) \quad (6)$$

The above equation indicates the AIDS demand function where  $P$  is derived from the following equation:

$$\ln P = a_0 + \sum_{i=1}^n a_i \ln p_i + 1/2 \sum_{i=1}^n \sum_{j=1}^n \gamma_{ij} \ln p_i \ln p_j \quad (7)$$

In effect, the price index is calculated under the following approximation Stone index instead of the equation 7:

$$\ln P = a_0 + \sum_{j=1}^n V_j \ln p_j \quad (8)$$

### Income Elasticity of AIDS Model

Derivation of equation 6 to the income is as:

$$\frac{\partial V_i}{\partial M} = \frac{\beta_i}{M} \quad (9)$$

Since  $V_i = \frac{p_i q_i}{M}$ , then:

$$\frac{\partial V_i}{\partial M} = \frac{\partial \left( \frac{p_i q_i}{M} \right)}{\partial M} = \frac{p_i \frac{\partial q_i}{\partial M} \cdot M - p_i q_i}{M^2} \quad (10)$$

The income elasticity in the AIDS models is Based on the equations 9 and 10 as follows:

$$\begin{aligned} \beta_i &= p_i \frac{\partial q_i}{\partial M} - \frac{p_i q_i}{M} = p_i \frac{\partial q_i}{\partial M} - V_i \\ \Rightarrow \frac{\partial q_i}{\partial M} &= \frac{\beta_i + V_i}{p_i} \Rightarrow \mu_{iM} = \frac{\partial q_i}{\partial M} \frac{M}{q_i} = \frac{\beta_i + V_i}{p_i} \frac{M}{q_i} \\ \Rightarrow \mu_{iM} &= \frac{\beta_i + V_i}{V_i} = \frac{\beta_i}{V_i} + 1 \Rightarrow \mu = \frac{\beta_i}{V_i} + 1 \end{aligned}$$

### 2- Former Studies

HashemiBanab and GhahramanZadeh (2005) examined the consumption pattern of food commodities. The results show that the hypothesis entitled "the consumers' income firstly is assigned among the different food groups and then it is distributed for the meat groups" is rejected. Jafari and Kohansal (2007) studied the demand function of several spices of meats and found that the fish and poultry meats are two substitutes.

Karagiannis and Mergos (2002) attempted to study the demand systems of food materials based on the cointegration technique in Greek. The practical result of this research under

the linear AIDS model indicated that the sample size, the patterns of information harmonization and the techniques for apply are the main factors in estimating the demand systems. They also concluded that the homogeneity property is sensitive to the sample size.

Ghorbani et.al (2010) Estimated the demand function for different meat using AIDS model in Iran. The results stated that the elasticity is smaller in short run rather long run. The income elasticity of demand also showed that the chicken meat at both short run and long run as well as the fish in short run are necessary goods.

AziziansTurkamani (2001) estimated the different demand function of meat in Iranian urban and rural areas using the AIDS system. The results show that the budget share of red meat at both the areas has been decreased while the budget for the fish and chicken has been raised gradually.

Fidan and Klasra (2005) studied that quarterly effect of demand for the red and fish meat in Ankara. The findings indicate that the consumption for the meats is change in different seasons. In particularly the consumption for the Muslims in Ghorban Celebrity is raised remarkably. The paper also confirmed that the red meat is an inelastic good, but the fish meat is elastic.

Skripnichenko and Chen (2002) combined the rarely Ideal demand function of Coper and Macklaren and the Ideal demand function of Musichi and made a new effective demand function. They estimated the demand function for meat and finally compare their demand function with the Coper and macklaren's function. The results confirmed that their new model is not appropriate as the Coper and macklaren's function it is.

### **Empirical Results**

We employed a system demand function for the groups of food materials in both rural and urban areas in Iran. It should be noted that we applied the Augmented Dicky Fuller (ADF) test to evaluate the stationary of variables. The results for this test indicate that all variables are stationary in their levels.

The income elasticity of demand verified that the groups including Meat, Rice, Oil, beverage and Dairy are luxury products for both urban and rural areas in Iran (this result has been confirmed in Torkamni (2001) study) while the group bread has income elasticity of demand value with less one.

### **Conclusion**

This paper examined the price and income elasticity of demand for Iranian non-durable food materials using AIDS system in the rural and urban areas during the period 1989-2007. Since almost the corresponding commodities are luxury in this review therefore we suggest the Iranian respective officials to focus more on the necessary goods that are important for the people.

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