Abstract

Pakistan's Banking sector has been obsequious to various forms of deregulation, liberalization, as well as dramatic amelioration in information technology (IT). Many of these changes have immense entailment for productivity, and the efficiency of the financial sector. This study is an endeavor to look into the magnitude of elasticity of substitution (EOS) among factors of production to analyze the impact of its trend prevailing in the Pakistani banking industry. It draws upon a comprehensive time series dataset covering the period 1980-2013. To achieve this purpose the current analysis employ flexible forms of production functions in order to follow up a quantitative evaluation of Elasticity of Substitution in the Pakistan's banking sector. A time series analysis recourse to econometric tests such as unit root tests and test of cointegration and Fully Modified OLS, are employ to estimate the non stationarity and identify possible long-run equilibrium relations and coefficients of production function. The empirical results emerged out demonstrate that the estimate of the EOS between capital and labour is significantly more than unity implying that substitution possibilities appears to be efficient tool to instigate positive outcomes without inevitably resulting in a decline in output. Findings facilitate in lime-lighting the importance of Elasticity of substitution as its high value implies that there prevails flexibility to adjust the factors of production in response to changes in factor prices and factor having higher productivity may be substituted for factor with low productivity.

Keywords: Productivity, Production Function, Elasticity of Substitution, Unit Root tests, Cointegration, Fully Modified Ordinary Least Square(FMOLS), Stationarity

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