Spatial Modelling of Disparity in Economic Activity and Unemployment in Southern and Oromia Regional States of Ethiopia

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ABSTRACT

Growth of productivity is the precondition to improve the living standard of people and maintain competitiveness in the globalized economy. However, wide regional deferential in labor force implies inefficiency as whole and might affect both aggregate unemployment and national output. The basic goal of this study was to model disparity in economic activity and unemployment in Southern and Oromia Regional States of Ethiopia, by incorporating spatial effects. Population and Housing Census data for 381 districts were used. The exploratory spatial data analysis, OLS regression model, and spatial econometric models were employed. The exploratory spatial data analysis results revealed that both economic activity and unemployment rates in a given district were directly affected by those of its neighbors. Economic activity and unemployment rates for males and females also spatially depended on that of neighboring districts. Spatial autocorrelations between unemployment and economic activity rates is negative. In modeling aspect, relying on specification diagnostics and measures of fit; spatial lag model was found to be the best model for modelling both economic activity and unemployment rates. The modelling results revealed that both estimates of spatial autoregressive parameters indicated the existence of spatial spillover in economic activity and unemployment rates. Spatial lag model analysis also demonstrated that average number of persons per household, crude birth rate, female and male unemployment rate were significant factors of economic activity rates. The factors, percentage of urban population, economic inactivity rate, percentage of self-employed population, percentage of unpaid family employers, and average number of persons per household were found as being factors behind disparities in unemployment rates across regions districts. In conclusion, as expected the economic activity and unemployment variables had the nature of correlation over space. It is recommended that most effective policy mix is required for stabilizing and alleviating disparity in both economic activities and unemployment of the districts considered in the regions.

Keywords: autocorrelation, spatial dependence, neighbouring districts, spillover

1. INTRODUCTION

1.1. Background of the Study

To investigate the evolution of regional productivity disparities in the countries (regions) the extent to which the existing interregional inequalities in productivity can be attributed to differences in sectoral composition and economically active people. A great deal of effort has been expended in to the question of what are the most important determinants of differences in income growth rates across countries and regions over the world. Spatially disaggregated analysis of the labor market appears to provide beneficial insights into internal forces and the ways external forces are transmitted via economic, social and political linkages (Maierhofer and Fischer, 2001). Regional sciences/studies use spatial data, which have special properties and need to be analyzed in different ways from non-spatial data attempts to address issues and problems faced by cities and regions by drawing on wealth of theoretical formulations about human spatial behavior typically based on statistical or econometrics methods (Anselin, 1988). Several factors: trade between regions, technology, and generally spatial spillovers may cause to geographically dependent regions (Haining, 2003); thus, appropriate model that incorporate spatial effect must be used (Haining, 1990; Rey and Montouri, 1999; Ward and Brown, 2009).

Large differences prevail in the geographical concentration of production and clusters of economic activities. An extensive literature finds numerous factors that taken together; explain why certain countries experience greater rates of income and employment growth than others. The most cited factors are stock of human capital, investment in technology, trade specialization, foreign direct investment, and low levels of political corruption. Besides, a more recent literature has explored the role of economic and political institutions in the economic growth of countries (Dominicis *et al.,* 2008). According to Kosfeld and Dreger (2006), the role of labor force is a key variable in many growth models and countries with high levels of labor force may potentially attract more firms thereby increasing the demand for labor which in turn raises wages and incomes. Spatial analysis of regional unemployment by Niebuhr (2003) revealed that a negative shock affecting regional labour markets in Europe. Unemployment can adversely affect productivity as well as productivity growth (Bräuninger and Pannenberg, 2002). Thus, as suggested by Taylor (1996), reducing regional unemployment differentials might lead to higher national output, lower inflationary pressure, and might produce large social benefits.

In the mid-nineties, urban Ethiopia had one of the highest unemployment rates worldwide (UN, 2003). Girma and Vanden (2006) showed that rural poverty remains a key development challenge for Ethiopia in general and Oromia in particular. Since the 1990s reducing persistent poverty and ensuring human development in Ethiopia have been the objectives of the Ethiopian government. Economic growth and distribution of income are the major instruments for reducing poverty, and the nature of growth have the most significant effect explicitly incorporated in various government development policy (MoFED, 2010).

Moreover, today reducing poverty and income inequality have been taken to be primary indicator of economic and social development in place of emphasis on economic growth. In order to halve the poverty by 2015, Ethiopia needs not only strong economic growth, but also robust expansion in the quantity and quality of employment opportunities particularly regional labor force which plays vital role (Berhanu *et al.*, 2005; IMF, 2009). Thus, this study has been designed to introduce measures of spatial autocorrelation and spatial econometric techniques to analyze the dependence of regional economic activity and unemployment rates in SNNPRS and Oromia Regional State of Ethiopia as a precursor to a wider study of the importance of local interactions and social networks in regional labor market outcomes.

1.2. Statements of the Problem

Growth of productivity is a precondition to improve the living standards of people and maintaining competitiveness in the globalized economy, however, low total productivity is the key reason for persistence of poverty in developing countries. And wide regional differentials in economic activities and unemployment imply inefficiency in the economy as a whole and might affect both aggregate unemployment and national output. Little systematic analysis has explored key labor market issues in Ethiopia in terms of important policy questions about how to facilitate job creation, productivity growth, and labour market efficiency particularly given the weakness of other factor markets that are in land and finance (UN, 2003). Although most of reports and research papers about the regions outline labour force status and dynamics in cross-section at household levels and over time, they didn't consider spatial dependence and heterogeneity in economic activity and unemployment of regions/districts in country level and/or regional levels.

Moreover, it may add remarkable change on the outcome of policies if spatial effects are investigated while assessing disparity of labor force status. If spatial dependence does point to the presence of interactions between spatially proximate regions and spillovers between regions, it will magnify local responses to national economic phenomena. Therefore, this study has been motivated to address the following research questions.

1. Is there spatial spillover in economic activity and unemployment rates?
2. What type of spatial association exists between unemployment and economic activity rates?
3. What are the statuses of spatial clusters in economic activity and unemployment rates?
4. Which model provides precise estimate and good fit to the economic activity rates and unemployment rates?
5. Which factors cause spatial variation in economic activity and unemployment rates?

1.3. Objectives of the Study

The general objective of this study has been to model disparity in economic activity and unemployment in SNNP and Oromia Regional States of Ethiopia by incorporating spatial effects. The specific objectives are:-

1. To determine spatial dependence in economic activity and unemployment rates.
2. To investigate whether spatial association exist between unemployment and economic activity rates.
3. To compare spatial dependence in economic activity and unemployment rates between sex groups.
4. To explore and identify clusters of districts with significant spatial autocorrelations.
5. To evaluate model best fit to the economic activity and unemployment rates.
6. To identify prominent factors those intensify geographical variation in economic activity and unemployment rates.
7. To provide scientific information for policy makers and researchers based on empirical results.

1.4. Significance of the Study

Geographically close districts with similar socio-economic characteristics and vulnerability dimensions are more conducive to grouping forces, such as the formulation of parallel policy initiatives. The clustering of underlying vulnerability dimensions might be due to a number of reasons including policy that has been applied to groups of areas or socio-economic issues that lead to spatial clustering. Thus, this study may make a payment to assessments and evaluations of labor force which contributes to its productivity across regions or districts. The study provides information on spatial distribution of economic activity and accumulation of unemployment that can be useful for planners to distinguishing geographically targeted preparation of development plan, monitoring, and evaluation of economic and labor policy.

The study suggests policy options for policy makers and development partners to adopt enhancement of economic activity, and minimize unemployment in relation with other development indicators to solve internal problems and external shocks (vulnerability). It also brings strategies to control and stabilize spillover of economic activity and unemployment over space to promote sustainable local socioeconomic development which tolerate rapid growth of country. Empirical results have important implications for planning as well as in searching left out variables, trends and dynamics that might account for the observed patterns throughout the regions. It also provides basic information for researchers to conduct study using others spatial process models, on other areas, and on identified factors along corresponding areas.

2. LITERATURE REVIEW

2.1. Concept of Economic Activity and Unemployment

According to UN system of national accounts production boundary economic activity involves the production of goods and/or services for sale or exchange and for own consumption. Activities include agriculture, any income generating services, hunting, fishing, forestry, logging, mining and quarry, and apprentices, etc. People are economically active if they are either employed or unemployed (waiting or seeking or available for job) in a particular period usually the survey reference week or year, whereas economically inactive people are people who are neither in employment nor unemployment on the International Labor Organization measure (ILO, 1993 and 2006). Reasons for inactivity are attending education, household chores, too young to work, illness, old age, pensioner, etc. Two useful measures of the economically active population are the usually active population measured in relation to a long reference period such as a year, and the currently active population or equivalently the labour force measured in relation to a short reference period such as one week or one day. Economic activity rate is the percentage of the population both employed and unemployed; who constitutes the manpower supply of the labor market regardless of their current labor status (ILO, 1982 and 2000). The labour force of a country or other geographic entity consists of everyone of working age typically above a certain age (around 14 to 16 years) and below retirement (around 65) who are actively employed or seeking employment (Hussmanns *et al*., 1990; ILO, 1998).

The international definition of unemployment covers persons without work, currently available for work and seeking work during the reference period (ILO, 1982). Economists also define unemployment as an excess supply of labor at prevailing wage rates. Unemployment rate is the percentage of economically active people who are unemployed on the ILO measure. People who are either actively looking for work or waiting to return to a job from which they have been laid off are classified as unemployed. In the traditional way, unemployment rate is calculated by dividing the number of unemployed persons by the number of labor force participants limiting both numerator and denominator to the working age population (ILO, 1982).

2.2. Labor Force Status and Socioeconomic Profile of Ethiopia

A high level of unemployment is one of the critical socio-economic problems facing Ethiopia. While the labour force grows with an increasing proportion of youth employment growth is inadequate to absorb labour market entrants. As result the inadequate employment situation of youth has a number of socio-economic, political and moral consequences. Based on the new economic policy, the government formulated a long-term economic development strategy Agricultural Demand Led Industrialization (ADLI) which is geared towards the transformation of the backward economic structure that generates high employment (Berhanu *et al.*, 2005). The Ethiopian economy remains heavily dependent on agriculture, which accounts for 50% of the GDP and accounts for 80% of employment (AfDB, 2008).

Over the last eight consecutive years the economy of Ethiopia has registered rapid growth. Accordingly in this period the annual average growth rate of GDP at constant basic price was 11.4%. As per the estimates, annual growth rates of the major sectors; agriculture, industry and service were 9.0%, 15.0% and 12.5% respectively, and their shares out of total GDP were about 41%, 13.4% and 45.6% respectively. According to the estimate done by ILO in 1995, Ethiopia had on average 48.29% of children aged 10-14 years economically active. Unemployment is one of the major social economic problems of a country (MoFED, 2011; World Bank, 2005). Agriculture sector is the predominant economic activity there by the largest contribution of the SNNP Regional State's GDP. Around 90% of the region population is mainly on agriculture, and engaged in farming, pastoral system, coffee production (SNNPRS, 2007). In 2005 economic activity rate is 60.23%, male economic activity rate of 65.36% and female economic activity rate of 55.23%. And with unemployment rate of 3.50%, male unemployment rate of 1.20% and female unemployment rate of 5.90% which was substantially lower than that of 1999 in both cases (CSA, 1999 and CSA, 2006). Over 90% of the people of Oromia Regional State live in the rural area, and agriculture economic activity has remained the source of livelihood for the majority of the people. In 2005 economic activity rate is 79.3%, male economic activity rate of 84.88% and female economic activity rate of 73.90%. And with unemployment rate of 4.10%, male unemployment rate of 1.70%, and unemployment rate of 6.90% which was substantially lower than that of 1999 in both cases (CSA, 1999 and CSA, 2006).

2.3. Determinants and Spatial Perspective Analysis of Economic Activity and Unemployment

The proportion of the working age population which is employed or seeking work (the economic activity rate) is a basic indicator of participation in the regional economy (Copus *et al.*, 2006). The dominating feature of economic activities is certainly clustering both in space and time, so the possibility of modeling the spatial dimension of economic activities is of paramount interest for a number of reasons. First the study of spatial concentration of economic activities can shed light on economic theoretic hypotheses concerning the nature of increasing returns and the determinants of agglomeration. A second important reason is constituted by the fact that the effects of policy measures to foster economic growth and development are strongly dependent on geographical clustering (Arbia and Quha, 2007). High number of children and their participation in household production were likely to impede investment in their human capital, maintaining the low income status of the household, and thereby creating or perpetuating a poverty fertility trap (Abbi *et al.*, 2006). The consequence of high fertility is that women's role tend to be limited to childbearing and other household activities in Ethiopia (Blen and Kimmel, 2009). Moreover, Elhorst (2003) stated that the structure of the population might have important influences on local labor demand and supply. From the economic point of view the level of education and additional skills play an important role as determinants of possibilities of finding a job in non-agricultural sectors, which are the base for sustainable rural development.

Unemployment in different sectors of economic activity responds differently to various macroeconomic shocks (Berument *et al.*, 2008; Stehrer and Foster, 2009). From spatial econometric model higher proportions of the population with qualifications are associated with lower levels of unemployment (Trendle, 2006). Mitchell and Bill (2004) used OLS and spatial econometric models and found that disparity in Australian unemployment rates were more apparent to the greater the level of spatial disaggregation employed and regional factors. By employing spatial Durbin models, Maria (2011) concluded that differences in labor demand, immigration rates, and urbanization were factors behind observed municipal unemployment disparities in Colombia. The migration is for the poor rates of convergence in regional outcomes tend to focus on wage differentials, low labor mobility and related structural impediments, and significant interactions occurred between the neighbouring regions, leading to more similar outcomes than one might expect from a truly random distribution (Mitchell and Bill 2004). According to Marston (1985) there is an equilibrium relation of unemployment rates across areas, high unemployment in the one area is compensated for by some other positive factors such as local amenities, climatic conditions, quality of life, local housing prices, etc which are a disincentive to migration. Elhorst (2000) included factors of unemployment: natural changes in the labour force, the participation rate, net immigration, wages, employment growth, the industrial mix, educational, market potential, and other characteristics of the labour market.

The empirical spatial econometric model by Nijkamp *et al*., (2007) show that regional difference in unemployment is strictly related to disequilibrium factors than to equilibrium variables in Italy. Employing OLS and spatial regression analysis, Artis *et al*., (1999) have found that employment and female participation have negative effect on unemployment; percentage of youth population has positive effect, differences in the share of manufacturing and agriculture employment in particular in Spain. Regional spillovers are most likely to exist in regions tightly linked by interregional migration, commuting and trade (Topa, 2001). The empirical findings of Overman and Puga (2002) show that the unemployment rates of European regions are much closer to the rates of adjacent regions than to the average rate of other regions.

3. METHODOLOGY AND DATA

3.1. Description of Study Area and Population

This study has been conducted in two of the regions (SNNPRS and Oromia) among administrative subdivided nine regional states in the Federal Democratic Republic of Ethiopia. The SNNPRS is located in the southern and southwestern part of Ethiopia with estimated total area of 110,931.9 square kilometers which is 10% of the country area. In 2007 the region totals population is 15,760,743 accounting nearly 20% of the total population of the country and projected population size in 2011 is 17,332,584 (CSA, 2008). The Oromia Regional State is occupying an estimated area of 353,006.81 square kilometers represents the largest regional state of the country. Based on the 2007 Population and Housing Census Oromia Regional State has a total population of 27,158,471 and projected population size in 2011 is 31,179,949 (CSA, 2008).

3.2. Sampling and Variables Under the Study

Cross-sectional secondary data spatially aggregated at district level across SNNP and Oromia Regional States on all variables have been used to conduct the investigation. Data for the study were extracted from 2007 Population and Housing Census, and shape file map was obtained from Finance and Economic Development Offices of both regions. To sample unit of analysis in fixed design especially for irregular shape polygon, the analogue of the classical situation in the case spatial data is the surface considered as a single realization (experiment) of random spatial process (Anselin, 1988; Haining, 1990; 2003). Spatial econometrics literature mainly focuses on increasing domain asymptotic under fixed sample design (Cressie, 1993; Lahiri, 2003) and model based approach to spatial sampling (Haining, 2003). Based on these issues, and particularly by assuming increasing domain asymptotic and permutation (Griffith, 1988) 381 districts in both Regional States were selected. The dependent variables are EA_RATE: Economic Activity Rate; is the percentage of the population age 10 years and above both employed and unemployed to both economically active and inactive people, and UNEMPR: Unemployment Rate; is the percentage of unemployed population over the total of economically active people. The independent variables and variables used in ESDA are: TOT_POP: Total population of district during census period, SEX_RATIO: Sex Ratio, URB_TOTPO: Proportion of population in urban area, EI_RATE: Economic Inactivity Rate, GOVTE_TOTE: percentage of government employers to total employed population, SELFE_TOTE: percentage of self-employed population, UNPD_FE: percentage of unpaid family workers, PROPO_TOTPO: percentage of productive population, DEP_RATIO: Dependence Ratio, AVEPRS_HSD: average number of persons per conventional household, NAC_G5: percentage of people aged 5 and above never attend school. CDR_1000: Crude Death Rate, URRU_100: percentage of population migrants from urban to rural area to total migrants lived in the place of survey for at least 6 months, UNEMPR_M: Male Unemployment Rate, UNEMPR_F: Female Unemployment Rate, MMR_100000: Maternal Mortality Rate, CBR_1000: Crude Birth Rate, RUUR_100: percentage of population migrants from rural to urban area, EA_RATEM: Male Economic Activity Rate, and EA_RATEF: Female Economic Activity Rate.

3.3. Methods of Data Analysis

3.3.1. Standard Multiple Linear Regression Analysis

Multiple linear regression analysis is used to estimate models to describe the distribution of a response variable with the help of a number of independent (predictors). In multiple linear regressions, a linear combination of two or more predictor variables is used to explain the variation in a response (Montgomery *et al*., 2001).

A standard multiple linear regression (OLS) regression model is a hypothetical relationship between dependent variable Y and independent variables X_1, X_2,. . . . , X_k described as:

$$Y_i = \beta_o + \beta_1 X_{i1} + \beta_2 X_{i2} + . . . + \beta_k X_{ik} + \varepsilon_i \text{ ....(1)}$$

In the equation (1) β_0, β_1, β_2 ... β_k, are called regression coefficients (parameters) and ε is independently and identically distributed error terms. The regression coefficient of independent variable quantifies the amount of change in Y corresponding to one unit change in an independent variable while all other predictors are held fixed at some specified levels. For cross-sectional data the basic assumptions of the multiple linear regression model analysis are: the relationship between the independent variables and the dependent variable is linear; the error terms are assumed to be independently and identically normally distributed with zero mean and constant variance; and no multicollinearity. Parameters are estimated by fitting model to the sample data using ordinary least square method reveals $\hat{\beta}_{OLS} = (X'X)^{-1}X'Y.$ To see significance of each independent variable (relative importance) on dependent variable T statistic is used, and to test significance of overall model one can use F-test and rejecting the null hypothesis if p-value is less than level of significance (usually α =5%). A number of checks and tests help us to ensure that analysis has proceeded within the bounds of the basic assumptions. Condition Number (K) is used to multicollinearity (Draper, 1998; Johnoston *et al*., 1997), Jarque and Bera test is used to test normality of errors (Montgomery *et al*., 2001), Breusch-pagan test, Koenker-Bessett test and White test are used to test homoskedasticity (Johnoston and Dinardo, 1997; Montgomery *et al.*, 2001). To making comparison between or/ and among models in the same class but differently specified R^2, Log likelihood, AIC, SC and SE of regression are used under this study (Montgomery *et al*., 2001; Darper, 1998).

3.3.2. Spatial Data Analysis

In statistics, spatial data analysis or spatial statistics includes any of the formal techniques which assess entities using their topological, geometric, or geographic properties that manifest them in space: location, area, topology, spatial arrangements, distance and interactions (Anselin, 1996). Spatial data set consists of a collection of measurements or observations on one or more attributes taken at space (Haining, 1990). The spatial data structures are Raster and Vector; there are three types of spatial data (Spatial Point Processes, Geostatistical Data, and Areal (Lattice) Data). In the context of standard spatial econometric models lattice data types are data for which aggregated value of spatial points of observation on each region at a time is used for analysis. Quantification of locations aspect of spatial data is based on location information from Cartesian space and contiguity (Lesage, 1999). Contiguity information is quantified as contiguity (spatial neighbors) matrix which contains elements of 1and 0; the matrix is denoted by W and constructed based Rock contiguity, Bishop Contiguity, and Queen Contiguity (Anselin, 1988; Lesage, 1999). The row standardized Queen Contiguity matrix **W** is called as spatial weighted matrix was used for quantification of location under this study. Lesage (1999) stated that in a regression context, spatial effects pertain to spatial dependence (spatial autocorrelation) and spatial heterogeneity. Spatial dependence is expected when sample data observed at one point in space is related to values observed at other. The spatial heterogeneity is simply structural instability in the form of non-constant error variances (heteroskedasticity) and/or spatial varying of model parameters (Graff *et al*., 2001).

Spatial heterogeneity can be thought as a special case of spatial dependence (Anselin and Getis, 1992; Anselin, 1988). The use of data organized by observational units in space and space-time, has given rise to some fundamental questions about appropriateness of application of statistical methods. Fundamental problems associated with analyzing spatial data and modeling spatial processes are: ecological fallacy and modifiable area unit problem (King, 1997), asymptotes in spatial stochastic processes (Anselin, 1988), boundary value and spatial sampling problem, properties of spatial connectivity, spatial non stationary, and others statistical perspective problems. In practice, these conditions are likely satisfied by most spatial weights that are based on simple contiguity, increasing domain and infill asymptotic approaches (Lesage, 1999).

3.3.2.1. Exploratory Spatial Data Analysis (ESDA)

ESDA is a set of techniques aimed at, describing and visualizing spatial distributions, identifying atypical localizations or spatial outliers, detecting patterns of spatial association, clusters or hot spots, and suggesting spatial regimes or other forms of spatial heterogeneity (Haining 1990; Bailey and Gatrell 1995; Anselin 1998). Spatial autocorrelation can be defined as the coincidence of value similarity with location similarity or dissimilarity (Anselin, 2000; Anselin, 1995), which can be measured by global and local indicators. The global indicator is Moran's statistic (*I*), which measures similarities and dissimilarities in observations across space.

$$I = \frac{n}{\sum_i \sum_j w_{ij}} \frac{\sum_i \sum_j w_{ij}(x_i - \bar{x})(x_j - \bar{x})}{\sum_i (x_i - \bar{x})^2} \text{...(2)}$$

The value of *I* is between -1 and 1; *I* =-1 perfect negative spatial autocorrelation, *I* =1 is perfect positive spatial autocorrelation, and I =0 signifies no spatial correlation. Inference on Moran's *I* take normal assumption and randomization or permutation approaches to determine the distribution of test for spatial autocorrelation under null hypothesis (Anselin 1995; Cressie, 1993). Measures of Local Autocorrelation are used when there is no global autocorrelation, and in case where measure of global does not enable us to appreciate the regional structure of spatial autocorrelation. The analysis of local spatial autocorrelation is carried out with two tools. First, the Moran scatter plot which is used to visualize local spatial instability (Anselin *et al*, 1996), and second local indicators of spatial association (I_i) which is used to test the hypothesis of random distribution by comparing the values of each specific localization with the values in the neighboring localizations which is depicted by LISA maps (Anselin, 1995).

$$I_i = \frac{n(x_i - \bar{x})}{\sum_i (x_i - \bar{x})^2} \sum_j w_{ij}(x_j - \bar{x}) \text{...(3)}$$

In addition to the univariate spatial autocorrelation, multivariate spatial autocorrelation and LISA is also analyzed by employing a bivariate Moran's *I* statistic and local measures. The bivariate spatial autocorrelation centers on the extent to which values of one variable observed at a given location show a systematic association with another variable observed at the neighboring locations (Smirnov *et al*., 2002). Standard multiple linear (OLS) regression model with spatially autocorrelated residuals may violate the independence assumption for error term, consequently regression parameter estimate are no longer BLUE, consistency, and unbiased so statistical inference is unreliable. Hence the important issue in empirical spatial analysis is how one can detect the presence of spatial effects, and moreover, how one can distinguish between spatial dependence as a nuisance and a substantive spatial process (Anselin and Grifith 1988).

The following ESDA are applying to check the presence of spatial autocorrelation in OLS regression model residuals. Moran's Test for Regression Residuals (Cliff and Ord, 1981; Anselin, 1988), Lagrange Multiplier (LM) Tests: LM-error test (Burridge, 1980), LM-lag test (Anselin, 1988), Robust Lagrange Multiplier test for a spatial error process robust to the local presence of a spatial lag, and Robust Lagrange Multiplier test for a spatial lag process robust to the local presence of a spatial error. In all of these tests discussed above the null hypothesis is stated as there is no spatial autocorrelation in the ordinary least squares residuals and large values of test statistic (χ^2) with degree of freedom one lead to rejection of null hypothesis (Anselin *et al*., 1996; Kelejian and Robinson, 1992).

3.3.2.2. Spatial Regression Model: Econometric Approach

In the spatial linear regression model, spatial dependence can be incorporated in specification in two distinct ways; as an additional regressor in the form of a spatially lagged dependent variable (Wy) provide spatial lag model, and in the form of spatial lag error structure (Wε) provides spatial error model. In a simultaneous specified model, the focus is on the explanation of the complete spatial pattern; particularly simultaneous autoregressive models assume that the response at each location is a function not only of the explanatory variable at that location but of the values of the response at neighbouring locations as well (Cressie, 1993; Haining, 2003). The simultaneous spatial lag regression model of dependent variable Y for observation *i* and k independent variables is taking the following form:

$$Y_i = \rho\sum_{j=1}^{n} w_{ij}Y_j + \sum_{r=0}^{k} x_{ir}\beta_r + \varepsilon_i \quad \text{..(4)}$$

where, ρ is a spatial autoregressive coefficient which is scalar, the k explanatory variables and intercept are x_{ir}, r =0, 1, 2…k with associated coefficient β_r, w_{ij} denote the (i, j)th element of **W**, and ε_i is the error term normally distributed.

Spatial lag regression model is appropriate when we believe that the values of dependent in one unit *i* are directly influenced by the values of dependent variable found in *i*'s neighbors; this influence is above and beyond other covariates specific to *i*. The spatial lag term must be treated as an endogenous variable and proper estimation methods must account for this endogeneity; implies OLS estimates are biased and inconsistent due to the simultaneity. Thus, based on assumptions, the spatial process is stationary and possibly isotropic property over space, and **W** is non-stochastic and exogenous to the model; maximum likelihood estimation with usually attractive asymptotic properties of estimators is appropriate (Anselin, 1988 and 1999; Anselin and Bera, 1998; Lee and Kammarianekis, 2004; Pace and Lesage, 2009). With similar setting in spatial lag model, the spatial error model for observation *i* is noted as:

$$Y_i = \sum_{r=0}^{k} x_{ir}\beta_r + \lambda\sum_{j=1}^{n} w_{ij}\varepsilon_j + \varepsilon_i \text{...}(10)$$

where, λ is a spatial autocorrelation coefficient which is scalar, and ε_i independently and identically normally distributed with mean zero and constant variance.

This type of spatial regression model is appropriate when we believe that dependent variable is not influenced directly by the value of dependent as such among neighbors but rather that there is some spatially clustered feature that influences the value of dependent for single unit and its neighbors but was omitted from the specification (Anselin, 1999). The maximum likelihood estimation technique was suggested in concept of asymptotic properties of estimators for estimation of parameters (Anselin, 1988), and the estimator for spatial autocorrelation parameter is obtained from explicit maximization of concentrated log likelihood function. Most of statistical inference principally hypothesis testing in spatial models is based on Wald (W), Lagrange Multiplier (LM) and Likelihood Ratio (LR) tests that relaying on optimality properties of maximum likelihood estimators and functions of estimators (Anselin, 1988, Lesage and Pace, 2009). Each test statistic is asymptotically distributed as $\chi 2$ with 1 degree of freedom (Pace and Barry, 1997). Further diagnostics for normality, heteroskedasticity and presence of spatial dependence are also assessed for both models. Likewise measures of fit for models comparison, R^2, Log likelihood, AIC, SC and others are often useful. The lower value for AIC and SC, and higher value Log likelihood signifies the model is best/better fit (Draper, 1998).

4. RESULTS AND DISCUSSION

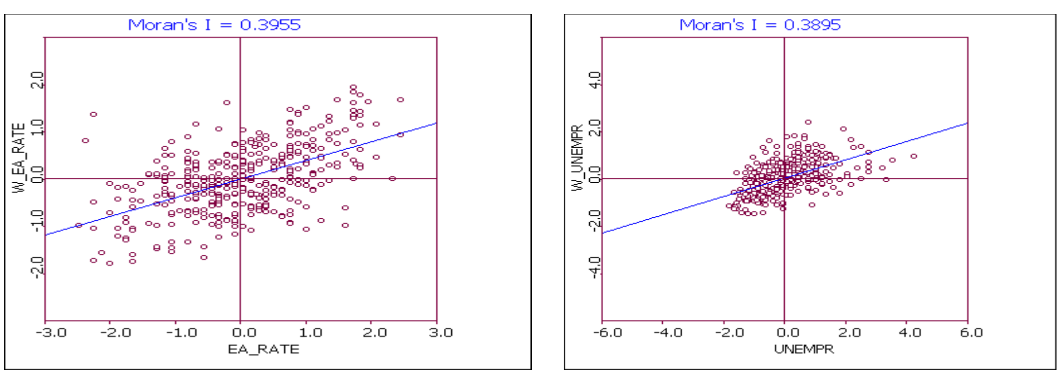
The analysis has been performed using data for 381 census districts. For spatial analysis, the sensitivity of our results with respect to different weights matrices was controlled, and then row standardized queen first order was found to be reasonable to study spatial effect. Table A1 in Appendix displays results of descriptive analysis for all variables considered under study. The economic activity rate ranges from 46.00% to 94.29% with mean 73.69% and standard deviation 8.33%. The unemployment rate ranges from 0.05% to 6.88% with mean 1.53% and standard deviation 1.00%. In similar manner we can interpret for the rest variables.

4.1. Exploratory Spatial Data Analysis for Economic Activity and Unemployment Rates

Table 1: Moran's Statistics (CSA, 2007)

	Variable	Moran's *I*	Standardized Moran's ***I***
Economic Activity Rates	EA_RATE	0.399*	12.24
	EA_RATEM	0.402*	12.11
	EA_RATEF	0.324*	9.33
Unemployment Rates	UNEMPR	0.3895*	11.46
	UNEMPRM	0.2871*	8.98
	UNEMPRF	0.2011*	6.11

The theoretical mean of Moran's statistics is -0.0026 and Moran's statistics that are labeled by * are significant at 5% level of significance. The standard deviation to standardized Moran's *I* and pseudo significance level was obtained from reference distribution of 999 permutations. From Table 1 Moran's statistics for economic activity rates (EA_RATE) and unemployment rate (UNEMPR) are significant at 5% level of significance as it can be seen from standardized Moran's *I* (p-value = 0.001<0.05). For each of three variables of economic activity and unemployment rates the null hypothesis states that there is no spatial autocorrelation, and it was rejected. Which means districts with high economic activity and unemployment rates were more likely clustered together, and those with low rates were more likely clustered together in space. Comparatively in both economic activity and unemployment rates, rates for male were more likely spatially correlated than rates for female (See Table 1).

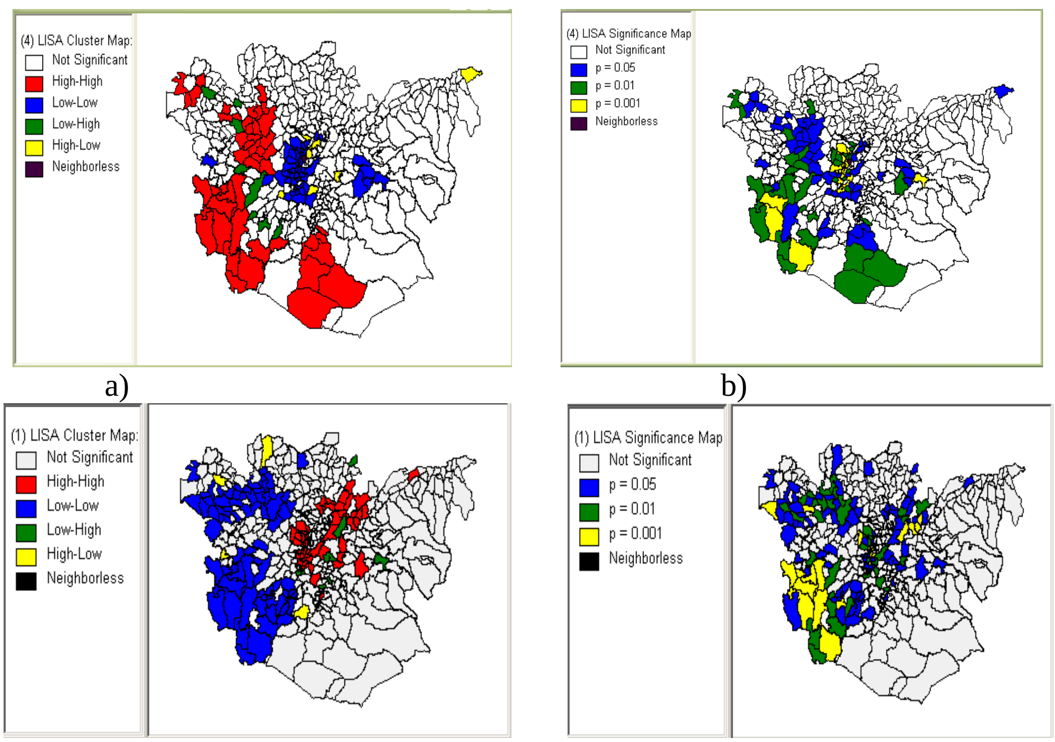


a) b)

Figure 1: Univariate Moran Scatter Plot for Economic Activity and Unemployment Rates

As shown in Figure 1(a) and (b) the visual level of the plots also verify the rejection of null hypothesis (no spatial clustering). Thus, the visual interpretations of Figure 1 are similar with quantitative results in Table 1, and lead us to believe that there is positive spatial autocorrelation in both economic activity and unemployment rates across the regions.

LISA significance and cluster maps of economic activity and unemployment rates were presented in Figure 2 below. Positive values of local Moran's statistic ($I_{i,}$ i =1, 2,…381) indicate positive spatial autocorrelation; a given district is surrounded by the number of districts with similar rates (either high-high or low-low). Whereas negative values of I_i indicate negative spatial autocorrelation; a given district is surrounded by the number of districts with dissimilar rates (high-low or low-high). LISA significance maps show districts whose local Moran's statistics are significant at 0.05, 0.01, and 0.001 levels of significance indicated with colors blue, green and yellow respectively, and classified by type of spatial association in cluster map (see Figure 2 (b) and (d)). The different marked locations in cluster map are indication of spatial clusters of districts with different combination of values for both economic activity and unemployment rates (see Figure 2 (a) and 2 (c)). Locations not marked by color on the map are those districts for which local Moran's statistics are insignificant.



d)

Figure 2: Univariate LISA Maps: (a) Cluster map and (b) Significance map for economic activity rates, (c) Cluster map and (d) significance map for unemployment rates

Bivariate ESDA is also employed to investigate evidence of spatial dependencies between unemployment rates and economic activity rates. In the Table 2 the Moran's statistics for all pair wise variables of unemployment and spatial lagged economic activity rats are positive and significant at 5% level of significance as we see from standardized Moran's statistics. This indicating that there is negative spatial correlation between unemployment and economic activity rates. Moran's I between male economic activity/unemployment and female economic activity/unemployment rates are positive and significant, which signifies districts with high male economic activity/unemployment rates are bordered by districts with high female economic activity/unemployment rates, or districts with low male economic activity/unemployment rates are bordered by those with low female economic activity/unemployment rates.

Table 2: Bi-variate Moran's Statistics between Unemployment and Economic Activity Rates (CSA, 2007)

Variable	**Moran's *I***	**Standardized Moran's *I***
UNEMPR vs EA_RATE	-0.251*	-7.76
UNEMPR_M vs EA_RATEM	-0.245*	-7.46
UNEMPR_M vs EA_RATEF	-0.232*	-6.94
UNEMPR_F vs EA_RATEF	-0.181*	-4.78
UNEMPR_F vs EA_RATEM	-0.144*	-4.35
UNEMPR_M vs UNEMPR_F	0.186*	5.51
EA_RATEM vs EA_RATEF	0.322*	9.54

4.2. Fitting OLS and Spatial Regression Models to Economic Activity and Unemployment Rates

Here OLS regression, spatial lag and error models were fitted to economic activity and unemployment rates; aimed to explain the empirical parametric strategy that has been used to assess the main district level factors of economic activity and unemployment rates. First OLS regression was fitted to assess the presence of spatial dependence in OLS residuals, and model adequacy checking results are also discussed. Unemployment rates were transformed using square root transformation whereas economic activity rates were not. Table A2 from Appendix shows the assumptions diagnostics results of normality, homoscedasticity, and multicollinearity for OLS regression models. As result, from diagnostics tests result the assumption of linearity, no multicollinearity, normality, and homoskedasticity were met. Next we proceeded to detect spatial dependence in OLS residuals; the tests used here comprise the Moran's *I* statistic, Lagrange Multiplier (LM) error and LM lag tests, and Robust Lagrange multiplier tests. These tests test the hypothesis states that there is no spatial dependence in OLS regression residuals. The Moran's Statistics and LM tests indicating presence of spatial dependence; however, it is difficult to discriminate dependence structure. Therefore, to identify the form of dependence in the model robust version of LM tests are relevant and LM-lag tests for both models on economic activity and unemployment rates are significant at 5% level of significance while LM-error tests are insignificant, which pointing that a model of spatial lag dependence is appropriate rather than model of spatial error dependence (See Table A3).

Moreover for confirmation and demonstration of models empirically standard measures of good fit and tests were collected from OLS regression, spatial lag, and error models analysis as an additional indicator of appropriateness of particular model in modelling economic activity and unemployment rates. Based on results from Table A4, spatial lag model is best fit to economic activity and unemployment rates than OLS and spatial error model; therefore, we limit our discussion to the results from the spatial lag model.

4.3. Spatial Lag Models for Economic Activity and Unemployment Rates

In this sub section detail demonstration of suggested best models is presented in modelling both economic activity and unemployment rates; a statistical model that incorporates spatial dependence explicitly by adding a spatially lagged dependent variable on the right hand side of the OLS regression model to overcome the spatial dependence found in OLS residuals was fitted.

Table 3: Maximum Likelihood Estimate for Factors of Economic Activity Rates in Spatial Lag Model (CSA, 2007)

Variable	Coefficient	Std. Error(±)	Z-value	Probability
W_EARATE (ρ)	0.2255	0.05189	4.3457	0.0000
CONSTANT	59.5880	4.68508	12.7186	0.0000
UNEMPR_M	-1.4589	0.62829	-2.3221	0.0202
UNEMPR_F	-1.5222	0.48326	-3.1498	0.0016
SELFE_TOTE	0.0442	0.04377	1.0085	0.3132
MMR_100000	-0.0034	0.00340	-1.0047	0.3150
PROPO_TOTPO	0.3130	0.45443	0.6888	0.4909
DEP_RATIO	7.8044	9.15451	0.8525	0.3939
AVEPRS_HSD	-3.7612	1.10231	-3.4121	0.0006
NAC_G5	0.0392	0.02477	1.5828	0.1135
CBR_1000	-0.0242	0.00628	-3.8605	0.0001
RUUR_100	0.0436	0.04307	1.0110	0.3120

In the spatial models specification particularly spatial lag models interpretation of the parameters becomes more complex. The complexity arises from the simultaneous feedback nature in the spatial lag terms, because spatial lag model involves feedback between neighbouring districts. The impact of a one unit change in an independent variable in a given district depends on its connections with other districts in the spatial system, and will vary from district to district. This implies that one unit change in explanatory variable has an impact on economic activity rate in the district, which then feeds to economic activity rates in all the other districts through the spatial lag, and these then feed back to the districts again through the spatial lag, and so forth. The dependence continues until some equilibrium is reached, but the effects in the second and subsequent round of adjustments get smaller and smaller. Assuming the feedback reaches at equilibrium steady-state, the effect of each explanatory variable in this model is reasonable in contrast to OLS estimate in such way spatial effect in account.

The significance tests of individual parameters in spatial lag model are asymptotically standard normal value; relative influence of each explanatory variable on economic activity rates. The positive estimate of spatial autoregressive (ρ =0.2255) is significant at 5% level of significance. This implies that economic activity rate in a given district directly depends on the economic activity rates in other neighbouring districts. The parameter estimate of the independent variables implies that economic activity rate in one area depends strongly on the change in independent variable in the same area and its neighbours.

From Table 3 male unemployment rate (UNEMPR_M), female unemployment rate (UNEMPR_F), average number of persons per household (AVEPRS_HSD), and crude birth rate (CBR_1000) had significant negative effect on economic activity rates. Maternal mortality rate (MMR_100000) has negative insignificant effect on economic activity rates. Percentage of self-employed population (SELFE_TOT), percentage of productive age group (PROPO_TOTE), dependence ratio (DEP_RATIO), percentage of population aged 5 and above who never attend school (NAC_G5), and percentage of rural-urban migrants (RUUR_100) had positive insignificant effect on economic activity rates. R^2 = 0.4122, measure indicates that 41.22% of variation in economic activity rates was explained due to variation in the explanatory variable and spatial lagged dependent variable. From Table A5 Breusch-Pagan test shows that there is no heteroskedasticity, because p-value of Breusch-Pagan test is 0.055 which is greater than 5% level of significance. In addition to these tests from Table A4 in Appendix Moran's statistics (I =0.0043) for spatial lag model is essentially zero; signifies that spatial dependence in residuals is eliminated due to inclusion of spatial lagged dependent variable.

Table 4: Maximum Likelihood Estimate for Factors of Unemployment Rate in Spatial Lag Model (CSA, 2007)

Variable	**Coefficient**	**Std. Error(±)**	**Z-value**	**Probability**
W_UNEMPR(ρ)	0.3536	0.0490	7.2118	0.0000
CONSTANT	0.4974	0.1214	4.0978	0.0000
TOT_POP	2.72×10^{-7}	2.47×10^{-7}	1.1021	0.2704
SEX_RATIO	0.0039	0.0027	1.4483	0.1475
URB_TOTPO	0.0187	0.0028	6.6280	0.0000
EI_RATE	0.0139	0.0015	9.0029	0.0000
GOVTE_TOTE	-0.0181	0.0172	-1.0534	0.2921
SELFE_TOTE	-0.0065	0.0026	-2.5065	0.0121
UNPD_FE	-0.0080	0.0025	-3.2060	0.0013
PROPO_TOTPO	-0.0085	0.0158	-0.5386	0.5901
DEP_RATIO	-0.0113	0.3196	-0.0354	0.9717
AVEPRS_HSD	0.0717	0.0404	1.7762	0.0457
NAC_G5	-0.0008	0.0009	-0.8850	0.3761
CDR_1000	-0.0015	0.0034	-0.4623	0.6438
URRU_100	0.0014	0.0016	0.8778	0.3800

Table 4 presents the results of analysis aimed to assess how much of the variation in an unemployment rate is explained by explanatory variables and their spatial lags. The parameter estimate for spatially weighted unemployment rates; the autoregressive parameter (ρ=0.3536) is positively significant at 5% level of significance. This implies that unemployment rate in a given district depends directly on the unemployment rate in neighbouring districts; a higher/lower unemployment rate in a given district significantly increases/decreases unemployment rates in the neighboring districts. In other words it measures the average influence of unemployment rates in neighboring districts on unemployment rates of particular district.

The explanation for degree of effect of independent variables on unemployment rates was made inconsideration of simultaneous feedback effect of neighbouring districts unemployment rates. Accordingly, positive sign of estimate indicates that a unit change in explanatory variable increases unemployment rate in district by magnitude of estimate of parameter for simultaneous effect of explanatory variable in that district and in all its neighbours of system. The negative sign indicates that a unit change in explanatory variable decreases unemployment rate in district by magnitude of estimate of parameter for simultaneous equilibrium effect of explanatory variable in district itself and in all neighbouring districts in study regions.

As we see from Table 4 percentage of urban resident population (URB_TOTPO), economic inactivity rate (EI_RATE), and average number of persons per family (AVEPRS_HSD) were positively significant at 5% level of significance. And percentage of self-employed population (SELFE_TOTE) and percentage of unpaid family workers (UNPD_FE) had significant negative effect. Percentages of government employed (GOVTE_TOTE), percentages of productive age group (PROPO_TOTPO), dependency ratio (DEP_RATIO), percentage of population aged 5 and above never attend school (NAC_G5) and crude death rate (CDR_1000) had negative insignificant effect on unemployment rates, whereas total population (TOT_POP), sex ratio (SEX_RATIO) and percentage of urban-rural migrants (URRU_100) had positive insignificant effect on unemployment rates. $R^2= 0.5681$ which notify us 56.81% of variation in unemployment rates is explained due to variation in the considered explanatory variables and spatial lagged unemployment rates. Likelihood ratio test be evidence for overall model is significant; suggests that spatial dependence of dependent variable allows the spatial lag model to be more important than the null model. Specification diagnostic test, the spatially adjusted Breusch-Pagan statistics is not significant; hence it indicates that variance of errors are constant in space (see Table A5).

5. CONCLUSIONS AND RECOMMENDATIONS

5.1. Conclusions

This study has analyzed the spatial effects in economic activity and unemployment rates for 381 districts in both SNNP and Oromia Regional States. The spatial effects in the data set have been analyzed by employing spatial autocorrelation methods; namely, ESDA and spatial econometrics models. From the empirical results there was evidence of positive spatial autocorrelation in both economic activity and unemployment rates. In particular male economic activity rates and male unemployment rates were more likely correlated in space as compared to that of females. The bivariate ESDA analysis revealed that there was negative significant spatial autocorrelation between unemployment and economic activity rates. Spatial autocorrelation between male and female unemployment rates was positive, and it is also positive between economic activity rates. The three models: OLS regression model, spatial lag and spatial error models for both economic activity and unemployment rates were compared. The spatial lag model was found to best fit to the data.

From spatial lag model analysis of both economic activity and unemployment rates, estimates of spatial autoregressive parameters were found to be positive and significant; indicating that the spatial lags exert direct effects on disparities of economic activity and unemployment in the districts across the study regions. From spatial lag model analysis of economic activity rates, we concluded that the economic activity rate was negatively affected by average number of persons per household, crude birth rate, female unemployment rate, and male unemployment rate. But, dependency ratio, maternal mortality rate, percentage of migrant from rural to urban area, percentage of productive age group, percentage of self-employment, and percentage of population age 5 and above never attend school had no statistically significant effects on disparity of economic activity rates in the regions.

The factors significantly affecting unemployment rates are percentage of urban population, economic inactivity rate, percentage of self-employment, percentage of unpaid family workers, and average number of persons per household. While total population, sex ratio, percentages of government employees, percentage of productive age population, dependency ratio, percentages of population age 5 and above never attended school, crude death rate, and percentage of urban to rural migrants had no significant effects on variation in the unemployment rates. In conclusion, as expected the economic activity and unemployment variables had the nature of correlation over space (districts). Which may indicate that economic activity created at a given location may create similar effect on that of neighbouring locations, and that in turn reduces unemployment rates in the area.

5.2. Recommendations

Although a growth of productivity is a precondition to improve the living standards of people, wide regional disparity in economic activities and unemployment imply inefficiency in the economy as a whole and might affect both aggregate unemployment and national output. Therefore, based on findings the following recommendations can be forwarded. The implication of spatial dependences insight the ways of policy directed towards reducing unemployment and prolong economic activity needs to have a spatial dimension. For low local significance area specific policy would support and for high clusters policy to be targeted towards not merely the specific area but the group of contiguous areas to promote sustainable local labour growth which tolerate rapid labour growth of country. We suggest that reducing unemployment rates, average family size and total fertility rate throughout the regions may enhance, and reduce disparity of economic activity rates. From demand side create provision of local job creation strategies, and from a supply side policy perspective programs will be designed to encourage people to participate in various employments. Furthermore, most effective policy mix for alleviating disparities in economic activity and unemployment rates of districts in study regions, balancing the industrial composition and others form employment, and encouraging population to actively participate in productivity possibly stabilize spatial spillovers in both economic activity and unemployment rates. We also recommend that further study may be conducted by incorporating time data and others proxies of factors.

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APPENDICES

Table A1: Descriptive Statistics of all Variables Considered under Study (CSA, 2007).

Variable	N	Minimum	Maximum	Mean	St.Dev (±)
EA_RATE	381	46.00	94.29	73.69	8.33
UNEMPR	381	0.05	6.88	1.53	1.00
UNEMPR_M	381	0.08	5.94	1.51	0.97
UNEMPR_F	381	0.08	9.70	1.58	1.20
SELFE_TOTE	381	32.96	85.37	62.26	8.15
MMR_100000	381	14.43	666.51	183.20	98.05
PROPO_TOTPO	381	38.36	63.51	45.93	3.25
DEP_RATIO	381	0.57	1.61	1.18	0.15
AVEPRS_HSD	381	3.18	6.24	4.85	0.36
NAC_G5	381	11.69	97.20	61.40	14.28
CBR_1000	381	436.00	1023.97	727.36	61.32
RUUR_100	381	38.11	96.82	87.73	8.75
EI_RATE	381	5.71	52.00	26.32	8.99
TOT_POP	381	12256.00	288457.00	103820.60	53172.50
SEX_RATIO	381	82.19	122.38	100.42	4.39
URB_TOTPO	381	0.00	33.11	7.02	5.29
GOVTE_TOTE	381	0.42	8.84	1.88	0.96
UNPD_FE	381	6.97	55.94	24.82	8.20
CDR_1000	381	4.60	35.38	11.95	3.88
URRU_100	381	3.18	61.89	17.26	8.75
EA_RATEM	381	58.50	95.38	79.09	6.97
EA_RATEF	381	36.47	94.23	68.27	11.37

Table A2: Assumptions Diagnostics Tests of OLS Regression Model for Economic Activity and Unemployment Rates

	Economic Activity Rates		Unemployment Rates	
Test	**DF**	**Statistic Value**	**DF**	**Statistic Value**
Jarque-Bera test	2	2.521	2	5.2532
Breusch-Pagan test	10	17.807	13	13.7604
Koenker-Bassett test	10	15.388	13	13.2009
White	65	104.397*	104	124.341
Condition Number:		25.165		28.42

Table A3: Diagnostics Test of Spatial Dependence in OLS Regression Model Residuals for Economic Activity and Unemployment Rates

Test	DF/MI	Statistic Value	Statistic Value
Moran's *I* (error)	0.1408	4.6238*	MI=0.206 (6.6380*)
Lagrange Multiplier (lag)	1	22.5581*	57.5374*
Robust LM (lag)	1	6.3515*	20.7811*
Lagrange Multiplier (error)	1	17.4769*	37.2033*
Robust LM (error)	1	1.2704	0.4470

Table A4: Tests and Measures of Fit in Modelling Economic Activity and Unemployment Rates

	Economic Activity Rates			Unemployment Rates		
Tests and Measures of Fit	**OLS**	**SLM**	**SEM**	**OLS**	**SLM**	**SEM**
R-squared	0.3738	0.4122	0.4106	0.4935	0.5681	0.574
Log Likelihood(LIK)	-1258.15	-1248.21	-1250.13	-1.6244	23.305	20.13
Akaike information Criterion(AIK)	2538.31	2520.42	2522.26	31.2488	-16.61	-12.61
Schwarz Criterion (SC)	2581.68	2567.42	2565.63	86.448	42.53	42.94
Sigma-Square	44.5184	40.584	40.6975	0.0613	0.0504	0.0496
Standard Error of Regression	6.6722	6.37	6.38	0.2476	0.2244	0.2228
F-test	22.09*	-	-	27.51*	-	-
Likelihood Ratio test (LRT)	-	19.89*	16.04*	-	49.859*	43.504*
Moron's *I* of Residuals	0.1409	0.0043	-0.017	0.206	-0.0071	-0.0246

Table A5: Diagnostics Tests for Heteroskedasticity and Spatial Dependence in Spatial Lag Models of Economic activity and Unemployment Rates

Test	DF	Value	Probability
Breusch-Pagan test (EA_RATE)	10	17.9972	0.0550
Likelihood Ratio test (EA_RATE)	1	19.8903	0.0000
Breusch-Pagan test (UNEMPR)	13	13.8846	0.3820
Likelihood Ratio test (UNEMPR)	1	49.8586	0.0000