

## The Impact of Unemployment on Economic Development: Georgia's Example

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### Abstract

This study explores the intricate relationship between unemployment and economic development, with a specific focus on the case of Georgia. High unemployment rates often signal economic challenges within a nation, and their consequences can extend far beyond the labor market. By examining Georgia's experience, this research aims to shed light on the multifaceted impact of unemployment on various facets of economic growth.

Drawing from statistical data and regression analysis, this study investigates the causal links between unemployment levels and key economic indicators. It delves into how unemployment rates influence factors such as GDP growth, income inequality, social welfare programs, and overall societal well-being. Furthermore, the study delves into the policy measures implemented in Georgia to combat unemployment and foster sustainable economic development. It scrutinizes the effectiveness of these policies, identifying successes and areas requiring improvement.

The insights gained from this analysis not only contribute to a deeper understanding of the dynamics between unemployment and economic development but also provide valuable lessons for policymakers and stakeholders in Georgia and other regions grappling with similar challenges. As nations worldwide seek to navigate the complex terrain of labor market dynamics and economic prosperity, the case of Georgia serves as an instructive example, highlighting the significance of addressing

unemployment as a critical component of a nation's economic growth strategy.

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**Keywords:** Unemployment, Economic Development, GDP growth

### Introduction

Naturally, the existence of such a complex and important problem as unemployment does not remain unnoticed by any state, and it fights with the latter with different levers - by implementing appropriate policies or various measures. Georgia is no exception. However, before reviewing the measures taken directly in Georgia to address the unemployment problem, let's first familiarize ourselves with the classification of the Economic Cooperation and Development Organization (OECD) regarding state employment policy<sup>1</sup>. This is divided into two directions: active and passive policies. More specifically, each includes the following:

- Professional training programs;
- Public employment services;
- Encouraging employment;
- Creation of new jobs;
- Encouraging startups;
- Support and rehabilitation of the labor force lacking the necessary skills.

The above instruments belong to the active employment policy, while passive policies include:

1. early retirement;
2. Unemployment insurance.

Back in 2013, the World Bank conducted research analyzing Georgia's statistical data and identified three main challenges:

- The country has working resources that cannot be used;
- Incomes are unevenly distributed;
- It is not possible to establish a balance between the demand and supply of different professions.

We should also mention the 2014 research conducted by the National Statistics Service of Georgia and the vocational school graduates. This research became the basis for the active employment policy strategy approved

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<sup>1</sup> COVERAGE AND CLASSIFICATION OF OECD DATA FOR PUBLIC EXPENDITURE AND PARTICIPANTS IN LABOUR MARKET PROGRAMMES;

<https://www.oecd.org/els/emp/Coverage-and-classification-of-OECD-data-2015.pdf>

in 2016, which was endorsed by the Government of Georgia on April 4, 2016. The objectives of this policy<sup>2</sup> were as follows:

- Creation of the conceptual, legal and operational framework necessary for the implementation of an active labor market policy;
- Development/adoption of legal acts to implement the strategy;
- Improving the quality of employment services;
- Eliminating the labor force demand/supply imbalance through training and retraining programs;
- Establishing a connection between public investment projects and the Ministry of Labor, Health and Social Protection of Georgia;
- Implementation of an effective system through which it would be possible to implement and monitor the active policy of the labor market.

On July 14, 2020, the Law of Georgia 'On Promotion of Employment'<sup>3</sup> was adopted, with the purpose of implementing an active labor market policy, facilitating the employment of Georgian citizens, promoting free competition and entrepreneurship, and ensuring equal access to employment promotion programs for Georgian citizens. We also find in the mentioned law that its aim is to establish an employment system where:

- Implementation of intermediary activities for employment in the labor market to achieve a demand/supply balance;
- Matching job seekers with employers;
- Stimulating job seekers;
- Adapting the labor force to the existing structural changes in Georgia's economy.

Some of the normative acts adopted by the Georgian government in the last decade (Tsartsidze, 2019) include:

1. Resolution of the Government of Georgia No. 199 "On Approving the State Strategy for the Formation of the Labor Market of Georgia and the Action Plan for the Implementation of the State Strategy for the Formation of the Labor Market of Georgia for 2015-2018" August 2, 2013.
2. Resolution of the Government of Georgia No. 733 "On approval of the concept of introduction and development of the labor market information system and the action plan for its implementation" December 26, 2014

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<sup>2</sup> Approval of the Active Labor Market Policy Strategy and its 2016-2018 Action Plan. [https://www.gov.ge/files/439\\_55453\\_143263\\_167.pdf](https://www.gov.ge/files/439_55453_143263_167.pdf)

<sup>3</sup> Law of Georgia "On Promotion of Employment" <https://matsne.gov.ge/ka/document/view/4924109?publication=2>

3. Resolution of the Government of Georgia No. 333 "On Approval of the State Program for the Development of Employment Promotion Services" July 18, 2016
4. Resolution of the Government of Georgia 12 "On the approval of the 2018 state program for the introduction and development of the labor market analysis and information system", January 15, 2018
5. Resolution of the Government of Georgia 7177 on amending the Organic Law of Georgia "Labor Code of Georgia". September 29, 2020
6. On December 28, 2020, the International Labor Organization will introduce new labor standards for statistical registration of the workforce, etc.

Naturally, this list represents only a subset of the measures the state has taken to address unemployment in Georgia and promote employment. Given that this issue remains a prominent concern, we believe that the mentioned policies alone are insufficient, and more significant effort, along with time, is needed.

### **Literature Review**

The correlation between unemployment and economic growth is well-documented in both local and foreign literature. Unemployment, often regarded as a negative phenomenon, encompasses various economic and social dimensions within a country. Economic issues stemming from unemployment include the denial of tax revenue to the population in the form of income tax and the loss of productive hours. On the other hand, social issues of unemployment are related to depression, lack of self-respect, and other vices such as robbery, prostitution, and more (Adarkwa, Donkor, & Kyei, 2017). Moreover, scholars also assert that unemployment is a multidimensional phenomenon that combines economic and social aspects, manifesting as both an economic activity and a social structure in society (Al-Habees & Rumman 2012). Therefore, the economic and social dimensions resulting from unemployment make it a complex issue that requires investigation into various factors to understand its nature and impact on economic growth.

The nature of unemployment depends on a country's structure and its classification as developed, developing, or underdeveloped (Soylu, Çakmak, & Okur, 2017). Unemployment, as a macroeconomic indicator, reflects a country's inability to fully utilize its abundant labor resources (Anghel, Anghelache, & Manole 2017). This highlights the presence of many active individuals seeking work who could potentially increase productivity but cannot secure employment. The International Labor Organization (ILO)

defines unemployment based on three crucial conditions that must be met simultaneously: not working, being ready for employment, and actively seeking work (ILO, 2019). According to the researchers Al-Hamdi Mohanedi and Alavin Mohamed, the theoretical analysis of unemployment represent the level of employment as a labor force associated with the degree of success, which in turn is related to economic growth (Mohanedi and Mohamed, 2016). Unemployment is classified as one of the most serious barriers preventing economic progress. The scientific literature notes that apart from being a source of livelihood on the street where people tend to commit criminal offenses against the law, unemployment is a great loss of labor to the country and it produces poverty in the sense that the lower the production, the lower There will be income and poorer will be the country and lower will be social welfare (Akinboyo, 1987; Raheem & Mufutau Iyiola, 1993). The problem of unemployment is not only intensifying in the conditions of globalization, but there are many opportunities to fight it even for such a small country as Georgia. Upon assessing the impact of foreign direct investment on the unemployment rate in Georgia since 2012, it was determined that the level of foreign direct investment significantly contributed to economic growth (Zhorzholiani, 2022). The researcher analyzed various macroeconomic variables and concluded that an increase in foreign direct investment leads to a higher employment rate, which, in turn, results in increased output and a subsequent rise in the country's gross domestic product (Zhorzholiani, 2022). A number of studies have presented conflicting findings on the relationship between the unemployment rate and economic progress. While there is limited literature on unemployment in Georgia, it is essential to investigate the impact of unemployment on the development of the modern Georgian economy. This research will contribute to the existing literature on the subject.

### **Data and Methodology**

Unemployment has been one of Georgia's significant and enduring issues for years (Figure 2 illustrates the unemployment level in Georgia from 1998 to 2022). Figure 1. displays labor force indicators in Georgia.

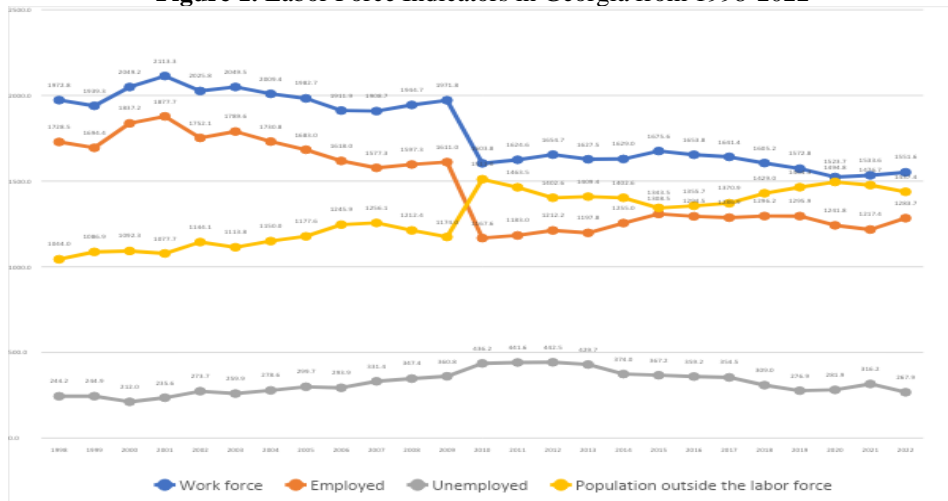
The unemployment rate has shown a notable increase since 2009, attributable to at least two factors:

- **Global Financial Crisis:** The crisis, stemming from the collapse of substandard mortgage lending in the US real estate market in the summer of 2007, had a cascading negative impact on other countries. In developed nations, unemployment levels surged from 5% to 9%, the world economy contracted by 3.3%, and stock and real estate prices plummeted. From the latter half of 2008, a slowdown in economic growth rates was observed across the globe.

- Political Destabilization in Georgia:** The "August War" of 2008 between Georgia, the Russian Federation, and Ossetian separatists further exacerbated the situation.

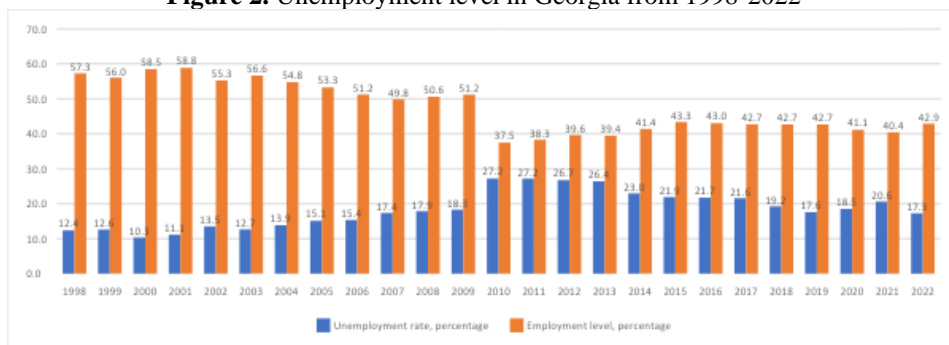
Consequently, Georgia endured challenging years. During this period, FDI and remittances to Georgia decreased significantly, inflation levels dropped, and a current account balance deficit emerged. All of these factors substantially worsened Georgia's economic situation, consequently affecting the standard of living. Specifically, in 2009, a negative economic growth rate of -3.65% was recorded, with the unemployment rate peaking at 18.3%, a substantial figure. To overcome the crisis, medium-term plans were developed in Georgia between 2010 and 2013, playing a crucial role in addressing the prevailing difficulties. This is corroborated by the provided statistical data (Figure 1), where we observe a decline in the unemployment rate starting from 2013.

**Figure 1.** Labor Force Indicators in Georgia from 1998-2022



Source: National Statistics Office of Georgia. <https://www.geostat.ge/en>

**Figure 2.** Unemployment level in Georgia from 1998-2022



Source: National Statistics Office of Georgia. <https://www.geostat.ge/en>

Another notable surge in the unemployment rate has been witnessed since 2021, attributed to one of the key events of this period - the emergence of the new virus, COVID-19. The virus originated in Wuhan at the end of 2019 and quickly escalated into a global pandemic, inflicting significant damage on national economies and individuals alike.

### Methodology and results

The country's gross domestic product (GDP) is a vital indicator that reflects the state, growth, and development of the economy. By examining Georgia's GDP over the years, we can demonstrate the impact of changes in the unemployment rate through regression analysis.

Table 1 displays the GDP growth rate and unemployment rate data from 2008 to 2022.

**Table 1.** GDP growth rate and unemployment rate data from 2008 to 2022.

Years	GDP growth rate	Unemployment rate
T	Dependent Variable	Independent Variable
2008	2,7	17,9
2009	-4,1	18,3
2010	7,2	27,2
2011	7,4	27,2
2012	6,4	26,7
2013	3,6	26,4
2014	4,4	23
2015	3	21,9
2016	2,9	21,7
2017	4,8	21,6
2018	4,9	19,2
2019	5,1	17,6
2020	-6,8	18,5
2021	10,5	20,6
2022	10,1	17,3

Source: National Statistics Office of Georgia. <https://www.geostat.ge/en>

Constructing a regression equation will reveal the relationship between the independent and dependent variables. Based on our data, the equation is as follows:

$$\text{GDPDV}=11.94776422-(-0.2543\text{UNIV})$$

Where: GDPDV is GDP growth rate (Dependent Variable) and UNIV is Unemployment rate Independent Variable.

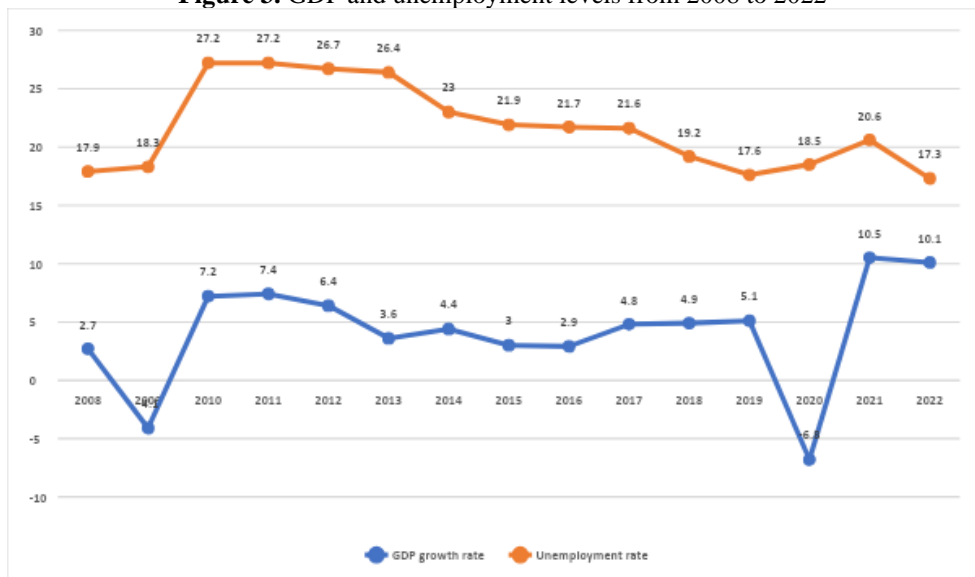
Based on the provided equation, we can conclude that unemployment and GDP growth are inversely proportional. Specifically, a 1% increase in the

unemployment rate corresponds to a 0.25% decrease in GDP growth. This relationship is consistent with the findings presented in this study.

Rising unemployment signifies a growing number of jobless individuals, resulting in reduced individual incomes. In response, the population curtails consumption expenditures, leading to decreased demand. This reduction in demand subsequently impacts output, causing a decline in the country's total domestic product and a slowdown in the GDP growth rate. This relationship is visually evident in the graph depicting changes in GDP and unemployment levels from 2008 to 2022 (Figure 3).

If we examine the curves, we can draw a similar conclusion. As the unemployment level in Georgia increases (the upper curve on the graph), the GDP growth rate decreases (the lower curve on the graph).

**Figure 3.** GDP and unemployment levels from 2008 to 2022



Source: National Statistics Office of Georgia. <https://www.geostat.ge/en>

Oaken's Law<sup>4</sup> is a valuable method for assessing the impact of unemployment on the economy. It helps estimate the absolute production losses resulting from unemployment. According to this law, a 1% increase in actual unemployment compared to the natural level reduces potential unemployment by 2.0-2.5 times. Specifically, Oaken's Law is expressed as follows:

$$\frac{Y-Y^*}{Y^*} = -\beta(U - U^*) \text{ or } Y^* = \frac{Y}{[1-\beta(U-U^*)]} \tag{1}$$

<sup>4</sup> [https://en.wikipedia.org/wiki/Okun%27s\\_law](https://en.wikipedia.org/wiki/Okun%27s_law)



Where:

$Y^*$ - Gross domestic product is the volume at full employment;

$Y$ - Nominal GDP the volume in the reporting period;

$U$ - The actual level of unemployment during the reporting period;

$U^*$ - Natural level of unemployment in the reporting period.

Let's illustrate this with relevant data, using 2021 as an example. This year is particularly significant due to the pandemic's impact and the noticeable increase in the unemployment rate. Plugging this data into the provided formula (1), we obtain the following result:

In 2021,  $Y^* = 76,16$  and the absolute loss of production caused by unemployment amounted to 21.35 billion GEL, a significant issue that cannot be overlooked for a small country like Georgia. This is a problem that must be addressed.

## Conclusion

To summarize the issues discussed in this paper, we can conclude that unemployment in Georgia has a detrimental impact on the country's economic development. Recent statistical data indicate that these efforts are insufficient, and we must acknowledge that combatting such a problem requires a significant amount of time. Unfortunately, time is a precious and costly resource in cases like these.

The regression equation presented in this paper confirms that an increase in the unemployment rate negatively affects the economy, with a 1% rise in the unemployment level resulting in a 0.2543% decrease in the GDP growth rate.

Several key issues should be prioritized by the state in light of the current reality. For example, stimulating the demand for labor, ensuring labor safety and rights, and enhancing the competitiveness of the labor force are areas that deserve immediate attention.

Furthermore, we believe that promoting globalization can be one of the solutions to address this issue. Despite the arguments that globalization can lead to complex problems and negatively impact the labor market, we assert that it provides an opportunity to combat global issues like unemployment. Through globalization, we gain access not only to resources, experiences, and knowledge within Georgia's borders but also to opportunities on a global scale. This broader perspective can be a significant step toward tackling such challenging problems.

Also, the Georgian government can further invest in human capital development since higher skills lead to increased productivity, which, in turn, is linked to lower unemployment.

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**Data Availability:** All of the data are included in the content of the paper.

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