



ევროკავშირი
საქართველოსთვის

Project funded by the European Union



Czech Development Agency

INTRODUCTION OF THE UNEMPLOYMENT INSURANCE IN GEORGIA: CHALLENGES AND ANTICIPATED OUTCOMES

Experts' opinion

Authors:

- **Ana Diakonidze** - Associate Professor of Sociology at the Tbilisi State University; Researcher at GPF
- **Ia Eradze** - Associated Professor at the Georgian Institute of Public affairs (GIPA); Researcher at GPF
- **Vakhtang Natsvlishvili** - Invited Lecturer at the Tbilisi State University; Researcher at GPF

Tbilisi, 2023

Some Constitutional Aspects of the Proposed Unemployment Insurance Scheme for Georgia

Opinion by Vakhtang Natsvlishvili

Introduction

This brief provides an overview of constitutional constraints and requirements that may apply to the unemployment insurance scheme presented in the policy report *Strengthening Social Protection for Workers in Georgia*, prepared by the International Labour Organization in cooperation with Expertise France in 2023.[1]

The ILO policy report discusses three design options for the prospective unemployment insurance scheme for Georgia, formulated in consultation with key stakeholders. All design options provide mandatory coverage for all paid employees from all sectors, while the minimum threshold of contributory earnings is set equal to the subsistence minimum. The summary for three design options looks as follows:

Table 1. Summary of three design options of unemployment insurance for Georgia
Source: ILO, 2023.

	Option A	Option B	Option C
Qualifying period	6 months in the 12 months preceding unemployment	12 months in the 24 months preceding unemployment	12 months in the 36 months preceding unemployment
Maximum benefit duration	4 months	6 months	9 months
Benefit level	50% of the average contributory earnings	<ul style="list-style-type: none"> • 60% of the average contributory earnings for the first 3 months; • 40% of the average contributory earnings for the remaining 3 months 	<ul style="list-style-type: none"> • 65% of the average contributory earnings for the first 3 months; • 45% of the average contributory earnings for the next 3 months; • The subsistence minimum for the remaining 3 months
Waiting period	7 days	7 days	7 days
Contributory earnings	Maximum: 1.5 times the national average earnings Minimum: The subsistence minimum	Maximum: 2 times the national average earnings Minimum: The subsistence minimum	Maximum: 2.5 times the national average earnings Minimum: The subsistence minimum
Total contribution rate	1.1 percent of the contributory earnings	1.4 percent of the contributory earnings	1.7 percent of the contributory earnings
Recommended rate for employers	0.55 percent of the contributory earnings	0.7 percent of the contributory earnings	0.85 percent of the contributory earnings
Recommended rate for workers	0.55 percent of the contributory earnings	0.7 percent of the contributory earnings	0.85 percent of the contributory earnings

In what follows, we will overview the constitutional provisions on taxes and social contributions, and inquire about whether mandatory unemployment insurance can be considered a tax. This is a crucial

question, as the Constitution of Georgia forbids the introduction of a new tax without holding a special referendum. Then, we will consider some aspects of the proposed unemployment insurance scheme, such as the minimum contributory earnings, the contribution rates, and the coverage, vis-à-vis the constitutional requirements.

Is Unemployment Insurance a Tax?

The Constitution of Georgia forbids the introduction and raising of taxes (except an excise tax) by parliament without holding a special referendum, which can only be initiated by the government.[2] According to the Venice Commission – an advisory body of the Council of Europe in the field of constitutional law – a referendum on taxes is a very rare figure in comparative law, and it transforms the principle of *no taxation without representation* into *no taxation without referendum*, leaving the Parliament of Georgia almost completely excluded from the politics of taxation.[3] The Organic Law of Georgia on Economic Freedom further specifies that a referendum on taxes can only pose the question of raising flat taxes for all – it forbids a referendum on progressive taxation.[4]

The constitutional requirement of a mandatory referendum to introduce a new tax or to increase the existing tax rate is extraordinary and unparalleled in the modern history of law. The idea behind enshrining a tax referendum in the Constitution of Georgia was to create the constitutional basis for the inviolability of the principle of economic freedom.[5] Many believe that the provision on a tax referendum entrenches neoliberal ideology in the country's constitution and cripples the ability of future governments to transform the current neoliberal model of economic governance.[6]

Is unemployment insurance a tax? In other words, does the country need to hold a special referendum before introducing mandatory social security contributions? The constitutional provision on a tax referendum was adopted in 2010. In 2017, the Parliament of Georgia amended the paragraph on tax referendum and made an explicit reservation, according to which *pension savings and insurance contributions should not be regarded as taxes*. [7] By making this reservation, the Constitution seems to allow Parliament to develop contribution-based social security schemes without being restricted by the provision on a tax referendum. The more so as the session reports of the Constitutional Commission of Georgia – a body tasked with preparing amendments to the country's constitution – unequivocally confirm that the aim of making such a reservation was precisely to allow Parliament to decide within its own discretion on the introduction of mandatory contributions, such as unemployment insurance.

Moreover, the Constitutional Court of Georgia in its case-law[8] has enunciated several principles of the notion of a tax:

- § Tax is a mandatory payment made by a person to the general government;
- § Tax serves to collect the necessary financial resources for the general functioning of the state;
- § Tax is an unrequited payment in the sense that it is made without expecting specific counter-performance from the government;
- § Mandatory payments made by a person to enjoy a specific good, to receive a specific type of public service, or to achieve a specific public goal are not to be considered a tax.

Unemployment insurance hardly fits the principles of a tax identified by the Constitutional Court of Georgia. Unemployment contribution is indeed a compulsory payment paid to the general government, but, unlike a tax, it confers an entitlement to receive a future social benefit. In other words, even though they are mandatory, contributions are to be paid not for the general functioning of the state, but in exchange for an entitlement to social security during times of unemployment.

Thus, social security contributions cannot be considered a new tax and there is no need to hold a special referendum before introducing the unemployment insurance scheme.

Minimum Contributory Earnings

The ILO policy report in its all design options recommends that the minimum threshold of contributory earnings be set equal to the subsistence minimum. The subsistence minimum is the minimum number of means of subsistence required to cover a person's physiological and social needs. It serves as a reference point for authorities to set a baseline for basic living support, and fix pensions, allowances, and other social benefits.[9]

Setting the minimum number of unemployment benefits seems to be an established practice across welfare regimes, as it ensures that the unemployment insurance scheme does not exclude low-income and vulnerable workers, who are typically the most affected by a job termination. However, the methodology for setting the subsistence minimum in Georgia has been highly contested for years. There appears to be a growing consensus that the current subsistence minimum does not reflect the actual costs of foodstuffs, let alone the costs of social and cultural living.[10]

The methodology to calculate the subsistence minimum has not yet been challenged before the Constitutional Court of Georgia. However, according to the definition applied by the German Constitutional Court, the subsistence minimum has two dimensions that must be satisfied. The first concerns the individual's physical existence and includes provisions for food, clothing, accommodation, heating, hygiene, and health. The second dimension is of a socio-cultural nature and aims at establishing a basic level of participation in social, cultural, and political life. These two elements must be protected in tandem: the government cannot ignore the socio-cultural dimension by claiming that it has supplied the means for physical existence.

The Constitution proclaims Georgia as a social state.[11] Stemming from the German constitutional jurisdiction, the principle of *sozialstaat*, in a normative sense, requires the government to pursue social justice as a constitutionally enshrined goal. In practical terms, it obliges the state to provide minimum levels of assistance to all vulnerable persons in need and to determine those needs in a statistically coherent manner so that the benefits paid cover the minimum subsistence costs.[12]

Thus, setting the minimum contributory earnings at the subsistence minimum is a constitutionally acceptable standard. However, the methodology of calculating the subsistence minimum itself has to be revisited so that it is consistent with the international standards and the actual costs guiding the subsistence minimum.

Contribution Rates

The ILO policy report presents the recommended contribution rates under all three design options: 1.1 percent for Option A, 1.4 percent for Option B, and 1.7 percent for Option C. In all three options, the recommended total contribution rate is to be divided equally between employers and workers.

Up to this day, the Constitutional Court of Georgia has not yet discussed the constitutional standards that guide specifically the rates of insurance contributions. However, the Court has long maintained a deferential mode when it comes to the constitutionality of fiscal policies. According to the case-law of the Court, the legislative and executive branches of government have a wide margin of discretion in fiscal matters, yet this discretion is not unfettered.[13] In a case involving the constitutionality of taxes, the Court declared

that the tax rates can only be challenged if they are so high and arbitrary as to undermine the essence of property rights; otherwise, it is up to the political branches of government to decide on fiscal policies.[14]

Thus, the suggested contribution rates seem to be in accordance with the constitutional requirements.

Coverage and Equality

All design options presented in the ILO policy report provide mandatory coverage for all paid workers from both the private and public sectors. However, the proposed scheme leaves out the self-employed and atypical workers from coverage. Excluding the self-employed and atypical workers from the unemployment insurance scheme could further aggravate their working conditions and generate stronger incentives for employers to rely on bogus self-employment or informal work arrangements and, by doing so, avoid paying the unemployment contributions.

The Constitution of Georgia secures the right to equality and prohibits discrimination on any grounds.[15] The Constitutional Court of Georgia employs different constitutional tests in reviewing the constitutionality of a law that treats equal persons unequally. In doing so, the Court assesses how intensive the unequal treatment is and inquires into whether there is objective justification for the differential treatment between seemingly equal persons.[16] The Constitutional Court of Georgia has not yet discussed the constitutionality of a law that differentiates between standard and atypical workers and excludes the latter from a social security policy. However, the argument presented in the ILO policy report – that due to the administrative challenges, the self-employed should not be covered at least before the unemployment insurance scheme proves to be efficient and sustainable for standard workers – does not seem to constitutionally justify the exclusion of the self-employed and atypical workers.

There is some telling case-law on this matter coming from different jurisdictions. In Mexico, the National Supreme Court found the unequal treatment between standard workers and atypical workers discriminatory and in violation of the right to social security under conditions of equality. In South Africa, the Constitutional Court declared unconstitutional the exclusion of domestic workers from the scope of the law on occupational injury.[17]

Thus, the proposed unemployment insurance needs either to extend the scope of its coverage so that it includes the self-employed and atypical workers or to provide alternative schemes for the self-employed and atypical workers to enjoy social security during unemployment.

Concluding Remarks

Based on the discussion above, it can be concluded that unemployment contributions, despite their compulsory nature, should not be regarded as taxes. The Constitution of Georgia clearly differentiates between contributions and taxes and allows the Parliament to introduce an unemployment insurance scheme without holding a special referendum. Moreover, the unemployment insurance does not fit the principles of a tax enounced by the Constitution Court of the country.

The introduction of an unemployment insurance system in Georgia does have the potential to protect workers against the risk of out-of-work poverty. However, as argued in this opinion, the country needs a more optimal policy mix to cover informal and atypical workers and provide minimum contributory earnings that allow low-wage workers, who are already at risk of poverty while in employment, to maintain a minimum subsistence level during the job loss.

-
- [1] International Labour Organization. 2023. Strengthening Social Protection for Workers in Georgia. Report II: Actuarial assessment of the proposed unemployment insurance scheme. Budapest: ILO.
- [2] Constitutional Law of Georgia on the Amendments and Changes to the Constitution of Georgia (adopted on October 13, 2017). Article 2.6. This paragraph is in force until 2030.
- [3] The Venice Commission (European Commission for Democracy through Law), 2017. Opinion 876/2017 on the Draft Revised Constitution adopted by the Venice Commission at its 111th Plenary Session. pp. 10-1.
- [4] The Organic Law of Georgia on Economic Freedom (adopted by Parliament on June 1, 2011), Article 1.5. The Organic Law allows the government to temporarily increase taxes for up to three years without holding a referendum (see Article 1.6).
- [5] Mikheil Saakashvili, Kakha Bendukidze, Georgia – the Most Radical Catch-Up Reforms, in *The Great Rebirth. Lesson from the Victory of Capitalism over Communism* (Anders Aslund and Simeon Djankov, eds.). Peterson Institute for International Economics. Washington, DC. p. 149.
- [6] See, e.g. Giorgi Maisuradze, 2020. A Pandemic and the Uncompleted Project of Georgian Statehood. Heinrich Boll Stiftung, South Caucasus Region. Tbilisi; Sopiko Japaridze, 2017. The Oligarchs’ Constitution. Jacobin Magazine.
- [7] Constitutional Law of Georgia on the Amendments and Changes to the Constitution of Georgia (adopted on October 13, 2017). Article 2.6.
- [8] See, e.g. The Constitutional Court of Georgia, Judgement N2/7/667, December 28, 2017; The Constitutional Court of Georgia, Judgement2/5/700, July 26, 2018; The Constitutional Court of Georgia, Ruling N1/6/1663, February 22, 2023; The Constitutional Court of Georgia, Judgement N2/1/877, December 25, 2020; The Constitutional Court of Georgia, Ruling N1/23/1487, November 12, 2020; The Constitutional Court of Georgia, Judgement N2/3/1279, July 5, 2019.
- [9] According to the Law of Georgia on the Calculation of the Subsistence Minimum (adopted by Parliament on April 17, 1997), the subsistence minimum reflects consumer goods per capita in value terms, which ensures the meeting of minimum physiological and social needs according to the level of the socio-economic development of the country (Article 2).
- [10] The Public Defender of Georgia and The Georgian Trade Union Confederation. 2016. The Compliance of the Georgian Minimum Wage Policy with the Social-Economic Development of the Country and International Commitments. Georgian version available at: <https://www.ombudsman.ge/res/docs/2019041113055440583.pdf> [10.11.2023].
- [11] According to Article 5.4 of the Constitution of Georgia, “the state shall take care of human health care and social protection, ensuring the subsistence minimum and decent housing, and protecting the welfare of the family. The State shall promote the employment of citizens. Conditions for providing the subsistence minimum shall be determined by law.”
- [12] See, Gantchev, Valery. 2020. Welfare Sanctions and the Right to a Subsistence Minimum: a troubled marriage. *European Journal of Social Security*, 22(3), 257-272.
- [13] See, e.g. The Constitutional Court of Georgia, Judgement2/5/700, July 26, 2018; The Constitutional Court of Georgia, Judgement N2/7/667, December 28, 2017.
- [14] The Constitutional Court of Georgia, Judgement N2/7/667, December 28, 2017.
- [15] See Article 11 of the Constitution of Georgia, according to which “any discrimination on the grounds of race, color, sex, origin, ethnicity, language, religion, political or other views, social affiliation, property or titular status, place of residence, or on any other grounds shall be prohibited.”
- [16] The Constitutional Court of Georgia relies on two different tests – the Strict Scrutiny Test and the Rational Differentiation Test – to evaluate the constitutionality of laws implying the unequal treatment between seemingly equal persons. For the sake of brevity, we do not discuss those tests in a nuanced way.
- [17] International Labour Organization. 2022. Making the right to social security a reality for domestic workers. A global review of policy trends, statistics, and extension strategies. Geneva.

Proposal of an Unemployment Insurance System and Its Implications for the Georgian Labour Market

Opinion by: Ana Diakonidze

Introduction

This paper aims at assessing the potential impact of the proposed Unemployment Insurance (UI) scheme in Georgia. The scheme was developed by ILO in cooperation with Expertise France in 2023 and it offers three options as outlined in the figure 1 below. All three options assume monthly contributions from the employer and employee and set the minimum for contributory earnings at the national subsistence minimum. As indicated in the concept paper setting such a low minimum serves the purpose of including the low-wage earners in the system. Maximum contributory earnings are defined as 1.5 times the national average wage in Option A, 2 times the national average earnings in option B and 2.5 times the national average earnings in option C. Qualifying periods as well as benefit levels and duration of the benefits differ accordingly in three options, with option A being the most modest and option C being the most generous one. Given the level of generosity (benefit duration of 9 months) option C requires highest rate of contribution (1.7% of the contributory earnings) and option A requires the least contribution rate (1.1% of the contributory earnings).

Figure 1: Proposed options for unemployment insurance in Georgia

	Option A	Option B	Option C
Qualifying period	6 months in the 12 months preceding unemployment	12 months in the 24 months preceding unemployment	12 months in the 36 months preceding unemployment
Maximum benefit duration	4 months	6 months	9 months
Benefit level	50% of the average contributory earnings	<ul style="list-style-type: none"> • 60% of the average contributory earnings for the first 3 months; • 40% of the average contributory earnings for the remaining 3 months 	<ul style="list-style-type: none"> • 65% of the average contributory earnings for the first 3 months; • 45% of the average contributory earnings for the next 3 months; • The subsistence minimum for the remaining 3 months
Waiting period	7 days	7 days	7 days
Contributory earnings	Maximum: 1.5 times the national average earnings Minimum: The subsistence minimum	Maximum: 2 times the national average earnings Minimum: The subsistence minimum	Maximum: 2.5 times the national average earnings Minimum: The subsistence minimum
Total contribution rate	1.1 percent of the contributory earnings	1.4 percent of the contributory earnings	1.7 percent of the contributory earnings
Recommended rate for employers	0.55 percent of the contributory earnings	0.7 percent of the contributory earnings	0.85 percent of the contributory earnings
Recommended rate for workers	0.55 percent of the contributory earnings	0.7 percent of the contributory earnings	0.85 percent of the contributory earnings

Source: ILO, 2023

Anticipated Benefits of Introducing Unemployment Insurance

There are at least two areas in which positive impact is to be anticipated with the introduction of UI scheme. Firstly, unemployment benefits have been historically devised as a measure of social protection for hired employees. As stated in the recent assessment by ILO and UN Women in Georgia¹ social protection benefits/measures exist for almost all groups of population in Georgia except for workers (hired employees). This is a crucial gap in the system, as it is the hired employees who finance the bulk of social protection system by paying income taxes and social contributions. However, in case of dismissal they are left without any support. Unemployment benefits will serve as a safety net for workers providing them with the feeling of security during unemployment spells. It will also prevent them from falling deeper into poverty after losing a job, thus improving overall socio-economic condition in the country. The unemployed may feel less pressure to accept any job immediately upon dismissal and can take time to invest in re-training and seeking better employment. This may lead to increased worker qualification levels – one of the bottlenecks faced by employers nowadays.

Another important issue is increasing the attractiveness of formal employment and thus reducing the share of informal employment. In several studies workers (including informal workers) in Georgia² have expressed readiness to forgo a share of their income in the exchange of income security during the period of unemployment. Thus, UI scheme may contribute positively to pulling more workers from informal into formal employment.

Last but not least, introduction of the UI scheme will also positively affect the quality of employment services in Georgia. At the moment State Employment Support Agency offers job seekers assistance in finding a job (job mediation) or inclusion in Active Labour Market Measures. All of this usually requires minimum of two to three weeks before actual placement into a job. Given the level of precariousness on the labour market unemployed often cannot afford spending time on self-development (enrolling in ALMPs or sifting through the jobs together with the employment counsellor) and turn to informal work, which yields immediate financial gain. Motivation to cooperate with the employment service may well improve when job seekers are offered monetary benefit during the period of job search.

Potential Negative Effects on the Labour Market

Coverage: who stays outside of the system?

Usual challenges associated with the introduction of Unemployment Insurance systems in less advanced economies with large informal sector relates to the issue of coverage. By design UI scheme will only cover workers who are in formal, hired employment. These represent 68% of the employed population in Georgia³. There are at least 3 other major groups of workers which will remain outside of the system (at least initially): self-employed, informal workers and non-standard workers. Acknowledging that there is a large overlap between these three categories of workers in real life, analytically they are distinct with each of them having specific needs and difficulties for inclusion in the UI system.

¹ UN Women/ILO (2020): Assessment of the Social Protection System in Georgia: <https://shorturl.at/qFIM5>

² UN Women (2021): Regulatory Impact Assessment of ILO C189 – Domestic Workers Convention: <https://shorturl.at/mGQY4>

³ National Statistics Office of Georgia (2023): <https://www.geostat.ge/ka/modules/categories/683/dasakmeba-umushevroba>

The ILO proposal acknowledges that self-employed will not be covered by the system and also notes that there are opportunities for the scheme to open up to include them later on once the system is well-established. This is indeed a common practice worldwide and can be well-applied in Georgia. The main issue with self-employed is that there is a higher risk of moral hazard since there is no “employer” present. Therefore, an UI system designed for the cases when the worker is dismissed against his/her will becomes difficult to administer as it is not possible to determine when the “dismissal” takes place. Nevertheless, self-employed are often invited to join the system voluntarily covering the share of employees’ as well as employer’s contribution.

Things get more complicated in case of disguised self-employment⁴ however, when worker is formally registered as self-employed, but in reality, finds him/herself in “*employment like relationship*” with another party controlling the working time and conditions. A recent research⁵ found that the share of such workers is sizable in Georgia and spans many layers of workers from platform workers (app-based drivers, couriers) to workers in the beauty industry, freelancing, etc.

Last but not least, (nonagricultural) informal workers represent 28% of the labour force in Georgia⁶. Thus, together all of these three categories of workers make up significant share of the labour force, who cannot join the UI system. On the one hand, this will limit the base for contributions undermining system effectiveness and on the other hand, it will further increase the segmentation on the labour market – an issue which is outlined in more detail below.

Increasing the segmentation on the labour market: winners and losers

Given the fact that UI benefits are proportionate to the contributions it is logical that high-wage earners will have better benefits compared to low-wage earners (because high wage-earners contribute more than low wage-earners). Therefore, the contributory systems usually reinforce existing inequalities on the labour market. This is a primary line of criticism of the continental (Bismarckian) welfare state, which is highly dependent on social insurance systems for providing welfare to its citizens⁷. Critical issue in case of Georgia is that low-wage earners represent about one fifth of all hired workers. More precisely, according to the PMCG Employment Tracker⁸ the share of workers earning less than GEL600 per month constituted 18.6% of all workers (see figure 2 below) in September 2023, with another 20% earning wages in the range of GEL 600 – 1199. Thus, little less than the half of the hired employees in Georgia receive less than the national median wage, which stood at GEL 1040 in 2022⁹. This points towards a high degree of segmentation on the labour market between a small pool of well-paid jobs and a much larger pool of jobs paying less than the national median wage.

An important question to ask is whether the low-wage earners (receiving less than GEL 600 per month) can get adequate social security from the UI system and whether these benefits will be attractive enough for people in informal sector to opt for formalization. For the low-wage earners monthly unemployment

⁴ ILO (2016): The Rise of the “Just-in-time workforce” -

https://www.ilo.org/travail/info/publications/WCMS_443267/lang--en/index.htm

⁵ Social Justice Centre (2021), Informal & Nonstandard Labour in Georgia: <https://shorturl.at/rGIU8>

⁶ National Statistics Office of Georgia (2023): <https://shorturl.at/AUV16>

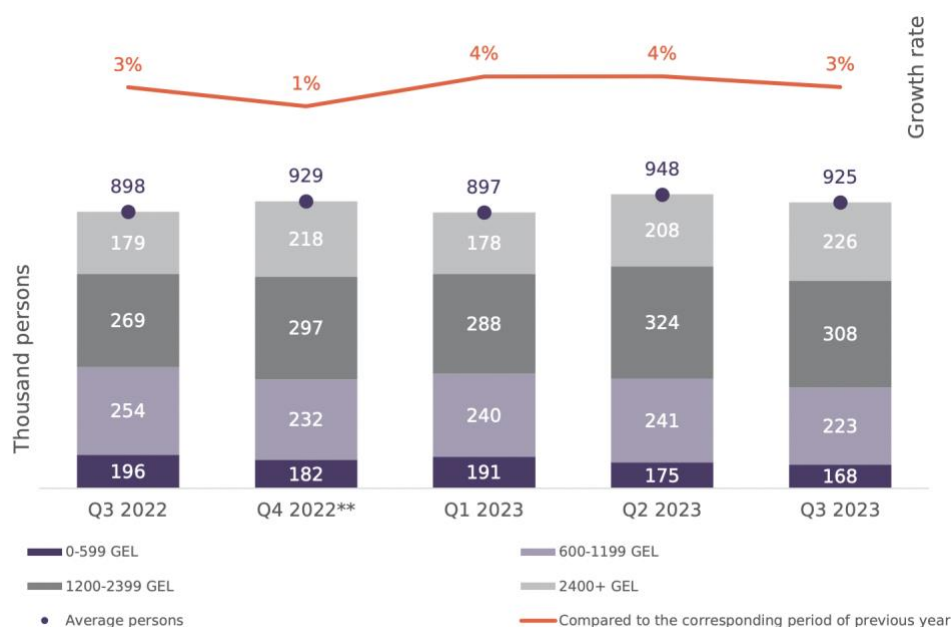
⁷ For more details on this see Hemerijck & Eichhorst (2009): Whatever Happened to the Bismarckian Welfare State? - <https://docs.iza.org/dp4085.pdf>

⁸ PMCG Employment Tracker (2023): <https://pmcg-i.com/publication/employment-tracker-october-2023/>

⁹ National Statistics Office of Georgia (2023): <https://www.geostat.ge/ka/modules/categories/39/khelfasebi>

benefits will range between GEL 300 to GEL 360 (depending on the chosen option). This is significantly lower than reported wages in certain areas of informal employment: e.g. a study on domestic workers found that average monthly wage of nannies and babysitters is between GEL 800 to 1000 per month¹⁰. Therefore, while all types of earners will be covered by the UI system, low wage-earners will benefit less, thus, existing inequalities on the labour market will be reproduced in the social security system. Moreover, people may still choose informal employment compared to low-wage formal sector jobs, as the perspective of meagre unemployment benefits may not be appealing.

Figure 2: Wage distribution in Georgia



Source: Revenue Service for PMCG Employment Tracker, 2023

Based on existing studies one could safely assume who would fall in the group of so called “losers”. We know that women and youth are disproportionately represented among the low wage-earners in Georgia. For instance, the share of female employment is higher in sectors like *Education* and *Wholesale and Retail*¹¹. “*Education*” has the lowest median wage compared to other sectors standing at GEL 747 in 2022, while median wage for “*Wholesale and Retail*” stood at GEL 950 in 2022¹². Although no age disaggregated wage data is published by the Statistics Office, it can be assumed that the lack of experience and qualifications puts young people at the lower end of wage distribution. For instance, supermarket chains which are known for notorious working conditions and low pay in Georgia primarily rely on the labour of young workers/students.

Last but not least, introducing unemployment insurance contributions will increase the non-wage cost of job creation. This will be a particularly heavy burden for the low wage-earners as they will have to pay UI

¹⁰ UN Women (2021): Regulatory Impact Assessment of ILO C189 – Domestic Workers Convention: <https://shorturl.at/mGQY4>

¹¹ UN Women (2020): Gender Pay Gap in Georgia - <https://shorturl.at/iIS38>

¹² National Statistics Office of Georgia (2023) - <https://www.geostat.ge/ka/modules/categories/39/khelfasebi>

contributions on top of income tax and pension contributions. This is a well-known issue for continental welfare states, which had to introduce a range of policy measures to overcome the negative effect on job creation (for instance, Germany allowed emergence of mini jobs, which are not subject to social security contributions). Alternatively, other countries (notably, Scandinavian welfare states) manage to relieve the burden by means of progressive taxation and exempting the low earners from income tax, while maintaining their obligation to pay social security contributions.

Conclusion

Based on the above discussion it can be concluded that introduction of the Unemployment Insurance system in Georgia has a strong potential for improving workers' income security and supporting the decrease of informal employment. Nevertheless, the impact on low wage earners, which constitute large share of the Georgian workers, needs to be examined more carefully. More precisely, as argued in this brief, there is a risk of the system not producing attractive enough benefits for the (informal) workers to opt for low-paying formal sector jobs. Considering that the contributory insurance system will replicate existing income inequalities on the labour market it is important that low wage earners are given extra support. This can be achieved, for instance, by reintroducing the system of minimum non-taxable income as practiced in Georgia several years ago. This would decrease the non-wage cost of job creation and increase the redistributive capacity of the UI system. Last but not least, once the system is well-established additional measures should be taken to include self-employed and other types of atypical workers whose inclusion in the system is not envisaged at the initial stage.

A Macroeconomic View on the Unemployment Insurance

Opinion by: Ia Eradze

Introduction: Importance of Unemployment Insurance for Georgia

UI and social welfare

Key aims of unemployment insurance globally are to support poverty reduction and encourage employability. Unemployment Insurance (UI) provides a basic guarantee for the labour that they will receive certain amount of money after they remain unemployed, for a limited period. This is why UI reduces chances of poverty right after unemployment. This type of insurance is especially important in the countries, where there is no welfare state and social protection system is either non-existent or inefficient. Georgia's social assistance system has faced a lot of critique, as it lacks many components, does not always target the most vulnerable groups, and leads to dependence on the assistance rather than sustainable reduction of poverty levels¹³. Moreover, due to high rates of unemployment (17,3%)¹⁴, income inequality (Gini coefficient is 34%) and poverty (absolute poverty – 15,6%, relative poverty – 19,9%¹⁵), UI is an absolute necessity in the given socio-economic context. As Georgia has a large share of informal economy¹⁶, UI has a potential to make formal employment more attractive. According to the National Statistics Office of Georgia (Geostat), in 2022, the share of informal employment in non-agricultural employment was 28,4%¹⁷. Thus, UI can enhance formalisation of the economy; consequent increase of tax base and budget revenues will contribute not only to the expansion of fiscal space, but also to the overall economic stability.

Even though unemployment benefits are treated with caution by some economists due to a fear of moral hazard, a clear differentiation should be made between unemployment benefits and an unemployment insurance. If the first is funded by the central budget, UI is not a state assistance, but an insurance – based on previous regular contributions of employees and employers. Furthermore, UI is limited in time – between three and nine months according to the proposed schemes of the ILO - and it cannot become a reason for a long-term unemployment of beneficiaries.

UI as an economic stabilizer

Unemployment Insurance is not only a necessity for poverty reduction and the improvement of overall social issues, but it can also have a positive impact on the economy. UI is often regarded as a stabilizer of the economy¹⁸, as it stimulates aggregate demand and consumption of the unemployed, by supplementing wage income partially. Therefore, UI is generally considered as a positive factor for smoothening of consumption patterns, as unemployment benefits are usually spent right away. Increase of demand (compared to non-UI situation) can also stimulate economic activity and employment. For such an import dependent economy as Georgia, the positive impact of stimulation of demand on the local economic output might be limited, as it might rather support consumption of imported goods. Yet, UI still stabilizes the overall economy, compared to the situation, where there is no insurance. It might also reduce social assistance payments by the government. UI also helps employers keep their working force in the times of crises. Furthermore, in the current context of major economic emigration from Georgia, UI can make employment in the country more attractive.

¹³ See Janiashvili, 2023.

¹⁴ Geostat, 2022, <https://www.geostat.ge/en/modules/categories/683/Employment-Unemployment>

¹⁵ Geostat, 2022, <https://www.geostat.ge/en/modules/categories/192/living-conditions>

¹⁶ The measurements of the informal economy in Georgia vary. IMF assumptions measure around half of the economic output as informal in Georgia (see Qeburia, 2021).

¹⁷ Geostat, 2022, <https://www.geostat.ge/en/modules/categories/683/Employment-Unemployment>

¹⁸ See for this debate Kekre, 2022; Bivens and Banerjee 2021; Vodopivec, 2013.

Table 1: Current Macroeconomic Indicators

GDP 2022	US\$ 24.6 billion
Average GDP real growth (2011-22)	4.7%
GDP per capita (2022)	US\$ 6,672
Average inflation rate (2009-22)	4.7%
External public debt / nominal GDP 2022	30%
Sovereign ratings	Fitch BB / Positive (27.01.23), S&P BB / Stable (11.08.23), Moody's Ba2 / Negative (28.04.22)

Source: National Bank of Georgia

Coverage of the UI: What to Do With the Self - and Informally Employed?

The suggested scenarios of the unemployment insurance by the ILO are meant to cover only those workers, who are employed in the formal economy, both in public and private sectors. However, it would be important to include the self-employed (32% in 2022, Geostat), as well. This is especially relevant for the Georgian context, where many self-employed in fact have employers, such as curriers or taxi drivers¹⁹. Moreover, Georgia has a large share of informal workers, due to a significant size of an informal economy, as mentioned above. In the times of crises and mass unemployment these groups are most vulnerable, as witnessed during the Covid Pandemic²⁰.

It is rather unlikely that informal workers can be included in the initial scheme of the UI, but at least the self-employed should be given a chance to participate in the program. In difference to the workers from the formal sector, UI can be voluntary for the self-employed. In terms of funding, the workers would need to cover the total contribution themselves, which would otherwise be split between employers and employees equally, according to the ILO proposition.

Unemployment Benefits

Revision of minimum benefit

The proposed UI scenarios of the ILO propose subsistence minimum as a minimum benefit of unemployment. On the one hand, this seems to be plausible as there is no minimum wage in Georgia, but on the other hand the existing subsistence minimum rate in Georgia (currently 250 Lari) is too unrealistic for funding the actual living costs. The methodology of counting subsistence minimum rate has not been revisited in the last decades²¹, even though it has been often criticized. A reform of the UI could be a good chance to finally tackle this issue and change the methodology of the subsistence minimum, which will subsequently increase its amount.

Differentiation of unemployment benefit rates

The ILO suggests fixed rates for calculating unemployment benefits, which is defined as a certain percentage of previous average earnings (see Table 2): 50% in scenario A, 60% (first three months) and

¹⁹ See Diakonidze, 2021.

²⁰ See Diakonidze, Natsvlishvili, 2020.

²¹ The law on subsistence minimum exists since 1997.

40% (following three months) in scenario B, 65% (first three months) and 45% (following three months) – in scenario C. This kind of fixed rates would make sense in a country which does not have a high income-inequality and large sectoral and/or gender discrepancies in wages. However, this is not the case in Georgia. The difference between average and median incomes in 2022 was significant, median earnings was 32.6% lower than average monthly earnings. For an illustration, if average wage in education, agriculture, administrative and support services does not exceed 1100 Lari, in information and communications it's more than 3000 Lari²². Differences are significant not only across sectors, but also between genders. In 2022, nominal average wage for women was 1247,7 Lari, while men earned 1827 Lari on average, according to Geostat. Adjusted monthly gender pay gap in 2022 was 23%²³. Due to these differences, male workers with high wages will benefit most from the UI. Moreover, Georgia has a flat income tax, where everyone pays 20% on their income. While this type of income tax already has ineffective distributional impact, fixed UI rates would reproduce and strengthen the existing economic inequalities in the country.

Table 2. Unemployment Benefits in A, B and C scenarios

Unemployment benefit	Scenario A	Scenario B	Scenario C
	<ul style="list-style-type: none"> The unemployment benefit is paid for a maximum duration of 4 months The benefit is 50% of the average contributory earnings over 6 months preceding the employment termination The minimum benefit is set at the subsistence minimum 	<ul style="list-style-type: none"> The unemployment benefit is paid for a maximum duration of 6 months For the first 3 months, the benefit is 60% of the average contributory earnings over 12 months preceding the employment termination For the remaining 3 months, the benefit is 40% of the average contributory earnings The minimum benefit is set at the subsistence minimum 	<ul style="list-style-type: none"> The unemployment benefit is paid for a maximum duration of 9 months For the first 3 months, the benefit is 65% of the average contributory earnings over 12 months preceding the employment termination For the following 3 months, the benefit is 45% of the average contributory earnings For the remaining 3 months, the benefit is the subsistence minimum The minimum benefit is set at the subsistence minimum

Source: ILO, 2023.

Therefore, it would be reasonable to establish differentiated rates for unemployment benefits, which would be defined in relation to initial wages. A minimum monthly wage threshold can be defined (for example 1000 Lari), and everything what is below, should enjoy higher rates than what is currently proposed in the ILO scheme. Flexible rates can be defined according to the deviation of initial wages from an average wage. Higher payments to low earning workers will increase the UI scheme costs. However, this funding gap can be covered by the government, as its participation is not considered in the insurance in the proposed scheme so far.

Lastly, as the calculations of the UI scenarios are based on average wage, it might be more reasonable to consider the median wage instead. Due to the reasons described above, median wage is a far better representation of the actual wages in Georgia than the average, and UI scenarios will be based on a more plausible measure this way.

Adjustment of benefits to inflation

It is recommended to adjust unemployment earnings to the annual inflation rate. Inflation is an important issue for the Georgian economy and as the experience shows, the rise of prices usually effects such essential

²² Geostat, 2022, Average Median Earnings of Employees.

²³ <https://www.geostat.ge/en/modules/categories/39/wages>

goods and services as food, medicine, utilities, and transportation²⁴. Wage rise mostly does not catch up with inflation rates and a large part of the population struggles to meet the costs of living even during their employment. Subsistence minimum rate is also adjusted to inflation rate, and this can be applied to UI earnings, as well.

Conditions for Receiving Benefits

The proposed UI scheme does not offer in detail information how the conditions for receiving unemployment benefits should be defined, but it is mentioned that the refusal of a job offer, or a training might lead the loss of the benefit. Requiring a proof of active search for employment from the unemployed (for example job applications, job interviews) and accordingly imposing sanctions, (if these requirements are not met), is not always effective²⁵. Firstly, this increases bureaucratic work and therefore administrative costs. Secondly, providing a proof for job search can easily be falsified. Lastly, and most importantly, the proposed scenarios are limited in time (from 3 to 9 months) and offer diminishing benefits after every three months. Therefore, the scheme provides a proper incentive for the unemployed to look for a job, as in scenarios B and C for example, UI benefits decline after every three months. Such a scheme will automatically motivate the unemployed to find a new job rather soon.

Macroeconomic Assumptions

Structural risks for the Georgian Economy

The Georgian economy faces structural economic risks, in terms of triple dependency on *foreign capital, foreign currency and foreign goods*. Dependence on foreign capital is not only expressed in the importance of FDI and remittances for economic growth and exchange rate stability, but it is also crucial for funding Georgia's current account deficit. Foreign currency dependence can be observed in the high level of unofficial dollarization of loans (44,9%) and deposits (49,7%). Even though dollarization has been decreasing, the indebtedness of households (29%), and business (63,9%)²⁶ is still high. Therefore, vulnerability to exchange rate fluctuations is significant for the employers, employees, and the government. Import dependency and trade deficit (deficit for goods is - 7580.7 mln USD)²⁷ is another key issue for the Georgian economy. In addition, difficult geopolitical context increases vulnerability of the whole economy, where employers and employees can be equally impacted negatively. Due to these structural risks that the Georgian economy faces, and difficult political and geopolitical context, it would be better to increase contributory earnings (currently 1,1% in scenario A, 1,4% in scenario B and 1,7% in scenario C) in the scheme, to build up solid reserves for the crises and mass unemployment.

Economic growth and unemployment

Economic growth and unemployment assumptions of the UI scenarios are realistic. Yet some more caution is needed, considering structural risks of the Georgian economy and accordingly the scheme might require more reserves, than planned in the existing model. According to the base scenario of the UI scheme, it is anticipated that Georgia's economic growth will continue, especially due to strong tourism. The assumption on medium-term growth is in line with the predictions of the NBG and the IMF, but high volatility of the Georgian economy should be considered, especially because of its dependence on tourism revenues. Tourism is one of the vulnerable sectors, as not only economic but also political and geopolitical processes can negatively influence the inflow of tourists.

²⁴ National Bank of Georgia, Macroeconomic Overview, 2023.

²⁵ See Asenjo, Pignatti, 2019, pp. 27-29.

²⁶ See National Bank of Georgia, 2023.

²⁷ Geostat, <https://www.geostat.ge/en/modules/categories/765/external-merchandise-trade>

Another major assumption of the base scenario is that the economic growth will contribute to the progressive reduction of unemployment. Yet, the statistical assumption on employment growth in the ILO report is rather cautious, which is plausible.

Economic growth in Georgia is not necessarily reflected proportionally in employment growth. Key engines for economic growth are the following sectors: trade, transport, accommodation and food supply activities, information and communication, art, entertainment, and recreation, as well as construction. In 2022 high economic growth was determined by services and increased demand²⁸, which was triggered by the increased number of foreigners (especially Russians) in Georgia. A sudden outflow of foreign citizens from the country might lead to significant changes, including the slow-down of economic growth, depreciation of Lari and widening of the current account deficit.

Inflation

In the first years of UI implementation low inflation is expected. Assumptions on anticipated inflation rates are plausible, and they are in line with the prognosis of the National Bank of Georgia. The Georgian economy is especially prone to the so-called imported inflation risks, which means the rise of prices on imported goods. This is most often materialized in the times of war, distortion of global value chains, or crises in producer countries. Due to Georgia's high dependency on imports, rising prices on oil, food or medication is directly reflected in domestic prices. There is also a risk of currency depreciation, as Georgian Lari is a volatile currency, and its depreciation makes imported goods more expensive. Despite all these structural risks, stable low inflation can be assumed for the next years in Georgia, because the mandate of the Georgian central bank is inflation targeting and the NBG prioritises price stability aims over other economic goals.

Conclusion

The adoption of the unemployment insurance in Georgia is highly recommendable, as it will improve socio-economic situation in the country. UI has a high potential of decreasing poverty, increasing employment in the formal economy, and encouraging economic growth. The proposed UI scheme by the ILO, with its three scenarios, provides a good basis for planning a UI reform. The model is built on credible macroeconomic assumptions, yet the reserves of the scheme could be planned more generously due to the structural risks of the Georgian economy and volatile (geo)political situation. There might be a need of increasing contributory rates to make the insurance scheme more robust for the times of crises. Moreover, it is recommended to differentiate unemployment benefits according to the deviation of initial wages from an average wage, to support equity in the existing highly unequal socio-economic context. Self-employed labour should be integrated into the system on voluntary basis already in the initial phase, which can also lay a ground for subsequent integration of the workers from in informal economy.

²⁸ National Bank of Georgia, Macroeconomic Overview, 2023.

References

- Asenjo, A. & Pignatti, C. (2019) Unemployment insurance schemes around the world: Evidence and policy options, Working Paper N. 49, International Labour Organization.
- Bivens, J. & Banerjee, A. (2022) How to boost unemployment insurance as a macroeconomic stabilizer. Lessons from the 2020 pandemic programs. Economic Policy Institute.
- Diakonidze, A. & Natsvlshvili, V. (2020) shroma da sotsialuri usaprtkhoaeba akhali k'oronavirusis p'andemiis p'eriodshi. Rek'omendatsiebi sakartvelos mtavrobistvis [Labour and social security during the pandemic. Recommendation for the Georgian government], Open Society Foundation Georgia, Tbilisi.
- Diakonidze, A. (2021) arap'ormaluri da arast'andart'uli shroma sakartveloshi [Informal and Unconventional Labour in Georgia], in: T. Chubabria (Ed.) arap'ormaluri da arast'andart'uli shroma sakartveloshi [Informal and Unconventional Labour in Georgia], Social Justice Center, Tbilisi.
- Geostat (2022) Employment and Unemployment. <https://www.geostat.ge/en/modules/categories/683/Employment-Unemployment>
- Geostat (2022) Living Conditions. <https://www.geostat.ge/en/modules/categories/192/living-conditions>
- Geostat (2022) Average Median Earnings of Employees. <https://www.geostat.ge/en/modules/categories/39/wages>
- [Geostat \(2023\) External Merchandise Trade. https://www.geostat.ge/en/modules/categories/765/external-merchandise-trade](https://www.geostat.ge/en/modules/categories/765/external-merchandise-trade)
- International Labour Organization (2023) Strengthening Social Protection for Workers in Georgia. Actuarial assessment of the proposed unemployment insurance scheme.
- Janiashvili, M. (2023) saarsebo shemts'eobis rolis sotsialuri datsvis sist'emashi [The role of social assistance in the social security system], Social Justice Center, Tbilisi.
- Kekre, R. (2020) Unemployment Insurance in Macroeconomic Stabilization, Working Paper 29505, National Bureau of Economic Research.
- National Bank of Georgia, Macroeconomic Overview, September, 2023.
- Qeburia, T. (2021) arap'ormaloba pandemiamde da pandemiis shemdeg [Informality before and after the Pandemic], in: T. Chubabria (Ed.) arap'ormaluri da arast'andart'uli shroma sakartveloshi [Informal and Unconventional Labour in Georgia], Social Justice Center, Tbilisi.
- Vodopivec, M. (2013) Introducing unemployment insurance to developing countries. IZA J Labor Policy 2, 1 (2013). <https://doi.org/10.1186/2193-9004-2-1>.