

# Relationship between Entrepreneurship and Unemployment: The Case of Georgia

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## Abstract

The research paper employs the regression analysis of two variables entrepreneurship and unemployment rate from year 2003 to 2013. Entrepreneurship development as a phenomena generating jobs plays a vital role in particular to alleviate high unemployment level in countries like Georgia. It concludes that for Georgia a country in transition entrepreneurship development plays a vital role for solving the unemployment problem. The analyses of two effects "Schumpeter" and "Refugee" have been tested. The effect of entrepreneurship has been found to be statistically significant.

**Keywords:** Economic transition, entrepreneurship, Georgia, unemployment.

## Introduction

The nature of the research on the relationship between entrepreneurship and unemployment as a legitimate academic pursuit has received increased attention among researchers and policy makers. The research in the field of entrepreneurship is expanding its boundaries by developing and exploring new explanations and prediction methods of entrepreneurship development and its relationships with other economic factors Georgia a post-Soviet country and inherited command economy, faced the problem of unemployment in its severe form. In conjunction with the reforms conducted after the Rose Revolution of 2003 that changed totally the shape of economy, for further development Georgian government promoted new laws and rules to harmonize them with the EU legislation. The first step is done: Laws on "Entrepreneurs" and on "License and Permission for Entrepreneurial Activity", Tax Code has been amended partly for better administration of relevant activities. It has been currently created an efficient mechanism and legislation for using agriculture and household lands. Private sector is still being slowly developed in spite of the fact that property has been transformed and private ownership and entrepreneurs have been established in the country. The war with Russia and financial crisis of 2008 damaged heavily the process of entrepreneurship development and increased further the level of unemployment. Lack of entrepreneurial skills and increasing level of unemployment drawbacks the whole economy. Experiences of developed economies and the role entrepreneurship played in their economic growth cannot be overemphasized as a result entrepreneurship has been suggested as a remedy for developing economies. (Carree M., Turik R., 2003) (Babtista R., Vansteil A., 2006)

Entrepreneurship development as a phenomena generating jobs places plays a vital role in particular to alleviate high unemployment level in countries like Georgia. Our theory bases on our hypothesis that entrepreneurship rate and

unemployment rate are negatively related. It is important to investigate the relationship between entrepreneurship and unemployment, where on one hand entrepreneurship may decrease the level of unemployment as a positive factor while on the other hand unemployment may increase or decrease the level of entrepreneurship. The research paper employs the regression analysis of two variables entrepreneurship and unemployment rate from year 2003 to 2013. The paper consists of five parts introduction, followed by literature review, methodology, results and conclusion.

## Unemployment

Unemployment is one of the main indicator of economic activity. Unemployment imposes a number of costs for nation, such as economic, social and physiological. The International Labor Organization (ILO) defines the unemployed as number of economically active population who are without work but available for and seeking work, including people who have lost their jobs and those who have voluntarily left work (World Bank, 1998). Unemployment rate is generally measured by using unemployment rate which is the percentage of labor force that is employed. There are various unemployment types are distinguished among the economists mainly, structural unemployment, cyclical unemployment, frictional unemployment and classical unemployment. Occasionally some additional types of unemployment are also mentioned such as seasonal unemployment, hidden unemployment, and hardcore unemployment. The magnitude of each one of these is difficult to measure, partly because they overlap (Sullivan A., Sheffrin S., 2003).

Currently the main economic problems, Georgia faces nowadays, definitely is labor market problems, since 1998 the unemployment rate in Georgia has been rising from

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12.4% all the way up to 14.6% in 2014 (National Statistics of Georgia, 2014). There are many explanations of such developments. Two main hypothesis from theoretical viewpoint are natural rate of unemployment or non-acceleration inflation rate of unemployment (NAIRU) which characterizes unemployment as reverting process with stable inflation rate (instead which is characterized with reverting unemployment and stable inflation. Another hypothesis is unemployment hysteresis according to which unemployment is defined as a non-stationary or unit-root process. (Lee C., Chang C., 2008. p. 313)

As a member of ILO, the methodology of calculation of unemployment rate in Georgia is standardized according to ILO rules, however, there are many questions with the term of "Self-Employed." Even though that in each countries statistical data contains the number of "self-employed, the number and effectiveness of them in case of Georgia is quite problematic. According to Georgian Statistics department 38% of employees are employed in the agricultural sector (National Statistics of Georgia, 2014) and classified (as) "self-employed" cultivating the land mainly for family needs. As this products cannot encourage GDP growth, the effectiveness of such employment is very low .Moreover another factor is that they consider themselves as unemployed and are ready to work. (Kvaratskhelia V., Mukbaniani N., 2011, p. 35)

Economists often consider unemployment as an inevitable process of searching for a job in a labor market. By nature individuals differ by the level of education, intelligence, experience, creativity and etc. Another factor is the variety of jobs, the requirements to perform, job condition, location, opportunity to advance in career and other characteristics.

## Entrepreneurship

Entrepreneurship is becoming more and more important in the world economy. There is no universally accepted definition of entrepreneurship. Entrepreneurship is a complex phenomenon that spans a variety of contexts. Varied definitions in entrepreneurship literature reflect this complexity (Bosma N., Acs J., 2009). Entrepreneurship as a term has a wide range of definitions. The meaning of Entrepreneur is defined as a person who organizes, manages, and assumes the risks of business enterprise. The definition has its root in the French word that means "to undertake". Entrepreneurship as it is today first was defined by an Austrian economist Carl Menger (1870), who argued that entrepreneurship emerge as people who seek out and take advantage of opportunities for profit, create goods that previously did not exist and finding new ways to create existing goods. Another Austrian economist Schumpeter's *The Theory of Economic Development* (1912) places the entrepreneur at the center of the process of capitalist development. Entrepreneurs are responsible for innovations (new products, new sources of supply, new production methods, and new forms of organization) that open up opportunities for profit, disturbing the system. Successful entrepreneurs will earn high profits and will attract imitators. Over time, imitation will eliminate profits earned by an original innovator and the system will settle down to a new equilibrium until it is, in turn, disturbed by another innovation. Schumpeter's vision of capitalism was

thus one of a system in continuous motion, the impetus for change coming from the entrepreneur. Unlike Schumpeter, Kirzner (1973) did not look at the entrepreneur as an innovative person with supernatural characteristics. In Kirzner's view, the entrepreneur is an agent who by exercising alertness "...grasps the opportunities for pure entrepreneurial profit created by temporary absence of full adjustment". According to Lucas (1978) for an entrepreneurship to grow, small business owner (entrepreneur) must be willing and able to relinquish many day-to-day control functions and delegate those tasks to an enlarged, specialized management team. Jovanovic (1982) proposes a life cycle model, in his model he argues that individuals learn about their abilities over time by observing how well they perform in tough business world. Historically entrepreneurs in Georgia often do exhibit the types of behavior described above, although the term entrepreneurship does not necessarily carry positive connotations in Soviet Georgia that it does in most developed market economies, and may even be viewed negatively. The fact that many entrepreneurial ventures developed in what was commonly referred to under communism as the "unofficial economy" reinforced the view of entrepreneurship as a "shady" activity. Since such activities often were considered illegal. It would be an oversimplification, however, to imply that entrepreneurship remains a "dirty word" after the collapse of Soviet Union. (I.Ozsoy, A.Dilanchiev, B.Gormez 2013).

There is growing concern among researchers that the term definition takes the central role in works and debates and focuses on terminology itself rather than developing a distinctive theory on entrepreneurship.

## Linking Entrepreneurship and Unemployment

The linkage between entrepreneurship and unemployment has been one of the debatable and interesting topics among the researchers so far. It was determined that relations between entrepreneurship and unemployment was analyzed mainly by two factors. First the (Shumpeters effect) pull effect and the second (Refugee effect) push effect. According to refugee effect the unemployment encourages entrepreneurship and according to Schumpeter effect entrepreneurship negatively relates to unemployment. (Varheul I., Stel A., 2006) (Audretsch D., 2007). Advocates of refugee effect argue that the increasing rate of unemployment decreases the possibility to get satisfying level of income and reduces the opportunities to get gainful job places, thus, this two conditions "pushes" the individual to start business activity.(Tervo H., 2002). Shumpeters effect assumes that development of entrepreneurship and new start-ups will provide employment opportunities and indirectly will influence the creation of employment in other existing firms. However, the lack of experience and low survival rate causes some of the new start-ups to close in a very short period which would limit the reduction of unemployment. (Wong P., Autio E., 2005. p.338). The relationship between entrepreneurship and unemployment has been shrouded with ambiguity, so that empirical evidence in this two conflicting concepts found that unemployment is associated with greater entrepreneurial activities while Evans and Leighton (1990) found that unemployment is positively associated with a great propensity to start a firm. Audretsch and Fritsch (1995) argue that unemployment negatively re-

lates to new venture start-ups and Career (2001) observe that there is no scientifically significant relationship between this two concepts. While defining the relationship between entrepreneurship and unemployment in Japan, Turik (2007) found out that effect of entrepreneurship on unemployment is not different than in other OECD countries even though that Japan’s unemployment rate has been influenced by specific exogenous shocks. In the analysis of the case of Portugal it has been found that a decrease in the agricultural value and the growth of the services sector has led to the emergence of “subsistence” entrepreneurship, which is associated with a very slight growth in the number of firms, therefore has limited number of influence on unemployment (Baptista R., Turik A., 2005). Consequently, there is not just theoretical reason but also empirical evidence that while unemployment causes increased self-employment, self-employment causes reduced unemployment.

**Methodology**

The paper tests two hypothesis which are based on the literary review mentioned above:

*H1: Higher rate of entrepreneurship decreases unemployment rate*

*H2: Higher the rate of unemployment, more people will start entrepreneurial activity*

The paper uses data relating to entrepreneurship and unemployment rate from 2000 to 2013 years. OLS) regression method was used based on data from Department of Statistics of Georgia (National Statistics of Georgia, 2014)

The variables that were used in research are following:

- **Overall entrepreneurial activity rate** is the percentage of population which is 15 and more and who are either involved in early –stage entrepreneurial activity or own or manage an established entrepreneurial unit.
- **The change between the entrepreneurship rates from 2000 to 2013** is calculated by taking average entrepreneurship rate.
- **Unemployment rate** is the percent of the labor force that is not working are without jobs and have actively looked for work within the past four weeks
- **The change between unemployment rates from 2000 to 2013** is calculated by taking average unemployment rate.

**RESULTS**

Regression analysis for the Dependent Variable “Change in the overall entrepreneurship rate”

R2= 0.768 R=0.590 Adjusted R=0.556

Predicators	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Standard Error	Beta		
<b>(Constant)</b>	-4,392	1.571		-2.79465	0.131
<b>Unemployment rate average from 2000-2013</b>	4,692	1.127	1.321	4.161704	

With the predictor 0.556 % of entrepreneurship is explained, however it is not scientifically significant because the level of significance is 0.131 which is more than 0.005.

Regression analysis for the Dependent Variable “Change in the overall unemployment rate”

R2= 0.826 R=0.6957 Adjusted R =0.657

Predicators	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Standard Error	Beta		
<b>(Constant)</b>	11.178	0.728449		15.34536	0.002
<b>Entrepreneurship rate average from 2000-2013</b>	1.265	3.03E-06	1.056	4.161704	

With the 0.657% of variance Change in overall Entrepreneurship rate average from 2000-2013 was explained. The significance level of 0.002 is less than 0.005 that makes the analysis significant at 95% level.

## Discussion

In this article the relationship between unemployment and entrepreneurship rate in Georgia between 2000 and 2013 years was analyzed. The results shows that we can with a statistical significance (delete) confirm that change in entrepreneurship has a positive effect on job creation by reducing unemployment level, which indicates that development of entrepreneurship is one of the key factor(s) in solving unemployment problem in Georgia. With the significance level of 0.002 and  $R=0.657$  we can say (conclude) that our analysis is scientifically significant concerning of regression analysis where independent variable is an average Entrepreneurship rate and it confirms the first hypothesis. However, the results of regression analysis for our second hypothesis are not scientifically significant so that, based on the data collection and years chosen it was found out that in the case of average unemployment rate from 2000 to 2013 variable significance level is 0.131 which is more than 0.005. The second results rejects our second hypothesis which means that in case of Georgia the Higher rate of unemployment, does not encourage people to start entrepreneurial activity.

The main limitations of the research were the years the data was collected in years that were chosen so that the numbers before the 2003 is period of transition and after the period of Rose revolution. The main problem is the identification of entrepreneurship as it is in it terminology in case of Georgia. Taking into account the changes in countries economical system and its transition from a command to a market economy entrepreneurship development becomes very difficult and stereotypes from the Soviet time, viewing entrepreneurship and entrepreneurial activity as shameful, are transforming not so fast.

## Conclusion

The research found out the importance of entrepreneurship development as a remedy to solving an unemployment problem and could not confirm the hypothesis that unemployment encourages the creation of employment. In the contemporary world entrepreneurship plays an important role and for countries in transition like Georgia the development of entrepreneurship and entrepreneurial skills is very important not only because it can help to solve the unemployment problem but at the same time other social problems that stem from it. Under the circumstances of a transitional period Georgian economy has still faced some economical, legal, legal, cultural and educational problems. The paper suggests the significance of developing entrepreneurial skills and takes necessary actions based on promoting of entrepreneurial thought. Along with allowing small credits and developing suitable conditions to encourage entrepreneurship it should not be overestimated the importance of education cannot be overestimated. Absence of necessary entrepreneurial skills and education in this field can minimize the efforts made by the government to develop entrepreneurship.

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