

## THE PROGRESS CLAUSE IN FOREIGN INVESTMENT CONTRACTS

**Maria Do Rosario Anjos**

*IPMAIA-Polytechnique Institute of Maia,  
IJP-Portucalense Institute for Legal Research, Portugal  
rosario.anjos@socadvog.com*

**Maria Joao Mimoso**

*Portucalense University,  
Portucalense Institute for Legal Research, Portugal  
mjmarbitragem@gmail.com*

### **ABSTRACT**

*This study aims to reflect on the principles to be followed in the concrete consideration of the interests of the contracting parties in foreign investment contracts. The purpose of this reflection is to achieve a fundamental reference framework that can serve as a basis for decision-makers, judges or arbitrators faced with the task of resolving disputes arising from foreign investment contracts. The most common mechanism for settling disputes in this venue is international arbitration. In this research we analyse the phenomenon of arbitration as a paradigm in the solution of the emerging foreign investment litigation, its benefits and its contribution to greater legal certainty in the economic relations between the parties and in the social progress of the host state. Considering the legal concepts and the most relevant problems in the relations between the investing State and the host State, we intend to establish a logic based on equity, proportionality and the right balance between the interests of both. We try to find a meeting point between the economic interests of the investor and the social progress of the host State. International arbitration under the umbrella of ISCID, complemented by bilateral treaties (BITs) and investment contracts, requires an approximation of the two main objectives of foreign investment: efficiency in the return of investment and technological and social progress of the host State.*

**Keywords:** *foreign investment contract, social progress clause, arbitration*

### **1. INTRODUCTION**

In view of the economic globalization that has developed in recent decades, there has been an increase in relations between large multinational companies and developing countries, with a lack of direct foreign investment to boost their growth and economic and social development. Foreign investment has thus become a strong and ubiquitous subject in the economic and legal community, awakened by the liberalization of markets and capital, with a set of new legal problems to solve. In this new world order, it is noted that the States of origin of foreign investors enter into agreements with the States potentially receiving such investment, with the purpose of protecting investors, namely securing the desired profit and outlining the legal framework regulating economic-legal relations between the parts. The latter, focused on the economic development of their territory and therefore avid for external capital, often accept agreements restricting their regulatory capacity and administrative power in the conduct and supervision of foreign investment contracts. It should be noted that the implementation of certain government policies aimed at improving the quality of life of the population has, from the point of view of investors, caused real violations of investment agreements. Although the latter contain the panacea of the obligations assumed by the parties, the host States are often limited in their regulatory power, resigning from the functions that are inherent to it, thus infringing upon the most fundamental rights. It is therefore imperative that the host States and the States of origin of the investors adopt a normative framework capable of reconciling and

balancing the interests involved and respect for those fundamental rights. For an effective protection of these Rights, it is urgently necessary to hold the investing entity accountable to society in general

## **2. LITERATURE REVIEW**

According to several authors, foreign investment is an instrument through which companies seek to capitalize, optimize production and access control of natural resources (Bohoslavsky, 2015, pp 4). The colonialist attitude of investors, centered on maximizing profits, has not allowed an effective development and social progress of the populations. (Jacob, 2010, pp16-17). The lack of concern for the protection of human rights has been the subject of reflection by the OECD, the United Nations and the European Union (Perez, 2016, pp 89). Transnational corporations with high economic power involved in investment should view corporate and social responsibility as a strategic factor in the market in which they operate. Their oligopolistic nature tends to divert their behavior from the social focus (Anjos, M. R. 2016, 88-91). To ensure long-term investment and its counterparts, investors must be involved in the social progress of host states (Pego, 2006, pp 44). The social welfare achieved from foreign investment is the main guarantee of business success and stability, both from the investor's perspective and from the host state [Costa, 2005, a), pp 16 and b), pp 21]. In these foreign investment contracts, the usual means of settling disputes is international arbitration, especially under the auspices of the World Bank. However, arbitration is dominated by the principle of contractual freedom and equality of the parties, which, in this case, does not occur, given the state of subjection of the host States, dependent on foreign capital (Soria, 2015, pp 5-6). This paper aims to reflect on all these issues, highlighting the need to reach a balance between the interests involved and their respective protagonists, prioritizing social and corporate responsibility and effective respect for human rights. In short, foreign investment contributes to an effective increase in the welfare and social progress of the population and not to a globalization of poverty (Chossudovsky, 2003, pp 10). Host States should not relinquish their role of caring for the effective public interest of their population. We must not forget that these are contracts with prerogatives of administrative law that cannot be left to the parties' will. The Administration of Host States cannot refrain from taking care of the general interest, since it is not its holder, but rather its servant and, therefore, the law must triumph in the face of arrogance and corruption. (MEILÁN GIL, J.L., 2013, pp 66-67).

## **3. FOREIGN INVESTMENT AND SOCIAL PROGRESS: "STATEMENT QUESTION"**

Foreign direct investment is an instrument that companies use to capitalize, to optimize production and to gain control over natural resources. The investor, through foreign direct investment, acquires a lasting interest in companies located in other territories, thus being able to operate across borders. The investment relationship presupposes, in most cases, the existence of a parent company and a foreign subsidiary, which is under the control of the parent company. It has been understood that such control acquires expressiveness with the ownership by the parent company of at least 10% of the shares or the voting right in relation to the second. Foreign direct investment boosts capital flows, which is why companies can expand their business through subsidiaries located in other states. Foreign investment is of particular relevance in the sectors of natural resource extraction, manufacturing industry and services. Not forgetting their contribution to sustainable development. But to what extent is the investor's contribution to the technological and social progress of the host state ensured in each foreign investment contract? Investment regulations should take into account the political, economic and social specificities of the States involved, the global situation and the international market, not neglecting the living conditions of the populations in the territories where the investment will take place. Today, companies are the protagonists of world economic development.

It is necessary to reflect deeply on its role in the global world with the necessary assumption of social responsibilities and consequently protection of human rights. That said, it is necessary to analyze the means of solving these disputes by means of arbitration, especially that of foreign investment (ISCID), seeking to ascertain whether it is sensitive to social issues or not. These are the issues under review.

#### **4. THE IMPORTANCE OF INTRODUCING A “PROGRESS CLAUSE” IN FOREIGN INVESTMENTS CONTRACTS**

The markedly colonialist behavior of investors has shown great disinterest in the face of the needs of the populations affected by the investment. In most agreements, investors are committed to improving the living conditions of populations, including the implementation of schools, hospitals and infrastructure. However, often after the realization of the investment, they forget the fulfillment of the social obligations assumed. It is urgent to hold investors accountable, but above all, the politicians in the host states for the lack of transparency and lack of sense of state in many of these foreign investment contracts. Put simply, it is necessary to introduce in each of these contracts, clauses suitable for the defense of the host peoples, in order to guarantee the general interest of the populations. In this sense, it would be enough to include a clause in foreign investment contracts, which would guarantee the obligation of the investment companies locally to provide technological, economic and social development resulting from the investment itself (MEILÁN GIL, J. L. 2006, pp 33-38). This "progress clause" to be included in each foreign investment contract should ensure that knowledge, training and manufacturing processes are shared between the parties in order to allow a fair share of the economic gains derived from foreign investment. To ensure, in short, that the investor undertakes to ensure the preservation of resources by adjusting production or extraction processes in accordance with technological knowledge and advances in science, protecting local populations and enhancing their economic and social development, the sectors targeted by this investment are often public services of general economic interest. The forecast in each contract of a clause stipulating public service obligations to be carried out in the host State may be, therefore, the factor of rebalancing the interests in presence. (MEILÁN GIL, J.L., 2006, pp 36). It is fundamental to counteract the tendency of a new world order based on the use of the resources of humanity, without equity in the redistribution of profits, which is nourished by poverty and destroys the environment, without respect for human rights and without concern for the well-being and progress population. This principle, based on fairness and proper consideration of the interest of the parties in the interest of the investor, but without prejudice to the general interest of the populations of the host state, must be present in all State conduct, whether in the negotiation of a contract of (MEILÁN GIL, 2013, pp 38), internal or international, or in the implementation of market competition in essential public services or, in the European designation, services of general economic interest (ANJOS, M.R. 2015, pp 29). Another path is unacceptable, unjust and generates potential conflicts of uncontrollable consequences for the fragile economies of the host states, to which political regimes are unstable and conducive to extremisms easy to settle in a context of unjust sharing of the benefits of foreign investment. Most of the existing studies on foreign investment are focused on analyzing the purely economic effects of investment (wealth multiplier effect / accelerator). From our point of view, we have to humanize the analysis. This is one of the reasons for this reflection. The focus of this paper is to highlight the importance of the impact of foreign investment on the social progress of populations. From this point of view, it is an approach focused on the humanization of the law itself, as an instrument of protection that promotes the well-being of the populations in the emerging economies (host states). Multinational companies must, in addition to corporate responsibility, be accountable to their shareholders and clients for their behavior, both in relation to workers and in relation to society in general.

This is a social and corporate responsibility, understood as the set of good practices developed by multinational companies, to guarantee workers' rights and protect the environment of the territory in which they operate (Costa, 2005, pp 46). Such accountability is intended to implement the social welfare of the community, bypassing the lucrative purpose, promoting the evolution, effectiveness and application of the domestic law of host States (Cardia, 2014, pp 18). Business practices should be based on models of economic, social and environmental sustainability. It is imperative to foster dialogue between all the protagonists. In the event of an emerging dispute, an appropriate balance of interests must be weighed, which requires sound, exempt and non-committal arbitration with the parties to the dispute. Nevertheless, the nature and power of the companies involved in foreign investment imposes greater care in order to avoid that the profits of the investment made are entirely absorbed by the investors to the detriment of the well-being of the populations in the host states. On the other hand, it is also necessary to protect the human and social rights of the peoples of the states where the investors come from, since their choice to carry out the investment in other countries is often motivated by the flight to the high social responsibilities that the legislation of the most developed states imposes, in particular, labor law, social protection and fiscal burdens (Chossudovsky, M. 2003, pp 78). In Europe, the European Commission announced in 2011 its new policy on corporate and social responsibility, although the results are still far from reaching the desired one. This responsibility should be a strategic factor for the competitiveness of companies, with a view to combating an inhuman globalization, alien to human rights and leading to an unprecedented globalization of poverty. (Chossudovsky, M. 2003, pp 81). In this regard, the benefits of social peace, risk management, cost reduction, access to capital, customer relations, human resources management and innovation capacity should be highlighted. In short, the social progress of the peoples will guarantee, in the long term, greater political stability, social peace and better reception of investment companies. Corporate and social responsibility must also be a mechanism that fosters good relations between companies, including employees and consumers, fostering sustainable business models that contribute to the increase of trust in relationships, reflected in growth itself (Nunes, 2015, pp 12-13). Finally, "corporate social responsibility is clearly in line with the objectives of the Europe 2020 strategy for smart, sustainable and inclusive growth, in particular with the employment target of 75%. Responsible business behavior is especially important when private sector operators provide public services "(European Commission, 2011, pp 10). Companies are now encouraged to adopt innovative strategies and minimize all negative impacts. In this sense, there are also international guidelines, notably the OECD and the United Nations, which tend to influence the behavior of companies regarding environmental protection and legal discipline of socio-economic relations. In this context, the United Nations has not only implemented a Global Compact to encourage companies to adopt social, corporate and sustainability policies, promoting dialogue between companies, trade unions, non-governmental organizations and others, as well as encouraging the global market, its inclusiveness and sustainability. In order to achieve this, the business community has been mobilized, especially internationally, through the implementation of principles, linked to human rights, namely in the field of labor, environment, anti-corruption and white-collar crime (Anjos, MR, 2016, pp 55).

## **5. THE IMPORTANCE OF THE “PROGRESS CLAUSE” IN ARBITRATION AS A MEANS OF SETTLING DISPUTES IN FOREIGN INVESTMENT**

In view of all the foregoing, we conclude that the introduction of a 'progress clause' in the clauses of foreign investment contracts is also crucial as a guideline for future arbitration decisions in dispute settlement. It should be pointed out, with reference to the famous and recent "Philip Morris vs. Uruguay" decision, that even in the absence of a clause expressed in the foreign investment agreement / agreement clauses, it is the duty of the arbitral tribunal to weigh

interests properly, proportional, fair and consistent with the principle underlying the merits of foreign investment. We argue that this 'progress clause' is an imperative enshrined in the spirit of contract law and the benefits of international trade. We know that investment agreements provide international arbitration as a means of settling disputes. While the investment brings benefits to the two parties involved, there are conflicting interests. On the one hand, investors want to maximize profits, and, on the other hand, States intend to take advantage of this relationship, either through fiscal policies or through the assumption of commitments as a currency of exchange for certain objectives to be attained. The recourse to arbitration also seeks to avoid the performance of the state courts of the host country of the investment. Let us not forget the great skepticism on the part of the investors as to the lack of impartiality of these organs, the procedural slowness, the inadequacy of the national laws and the complexity of the questions to be decided. They also invoke authoritarian political regimes, political instability and a lack of seriousness in the fulfillment of the contractual obligations assumed by host States. Infringement of such agreements gives rise to arbitral proceedings and, frequently, to the condemnation of host States in large amounts of compensation to investors. Thus, the arbitration clause inserted in the agreements is understood as a protective clause for the investment and the investor, with the particularity that only investors can sue the States through arbitration. Such a situation constitutes a genuine breach of the principle of equality between the parties, operating in stark disfavour to host States (Bohoslavsky, 2015, pp 16). The proliferation of foreign investment undoubtedly contributed to the regulatory easing of investment, with greater benefits in favor of the investor. The clauses of fair and equitable treatment, the most favored nation and expropriation are real examples of this. The generalization of standard clauses, general clauses and indeterminate concepts, allows great arbitrariness to the judge. Since the signing of the Washington Convention and the creation of the International Center for the Settlement of Investment Disputes under the World Bank, foreign direct investment litigation has mostly been submitted to ISCID arbitration. ISCID arbitration has been revealed by investors, often condemning host states for allegedly violating their Bilateral Investment Promotion and Protection Agreements (BIT'S). The Philip Morris judgment seems to have announced an inflection in this trend. But it is justified to clarify the spirit behind the defence of foreign investment with the engine of development.

## **6. CONCLUSIONS**

Regulating foreign direct investment is a controversial issue. The national laws of host states, which would be naturally applicable, as laws of the place where the investment occurs, have not been applied to this type of relationship because of the great skepticism of the investors. Their lack of flexibility and adequacy to this type of situation have undoubtedly contributed to their non-application. The option is to apply the rules contained in the agreements or investment contracts themselves and in the Public International Law, which regulates relations between States. An inevitable reflection on the assumption of corporate and social responsibility on the part of the investing companies is necessary (Kaushal, 2009, pp 5). It is important to consider the enormous economic and political power of these investing companies, accustomed to developing their activities in oligopolistic markets and holding a dominant position capable of controlling the political power of the host states (Pego, M. 2007, pp 46). Investment agreements should contain specific clauses capable of obliging their subjects to implement sustainable development, in addition to protecting purely economic interests. This clause requires the introduction of a 'progress clause', which imposes an obligation to promote technological, productive and social progress by the investor. We also know that foreign investment is mainly focused on certain sectors, namely in mining, chemical, iron, petrochemical, energy, gas, telecommunications, among others. These sectors, as we know, are responsible for the emission of pollutants with a strong environmental impact.

Therefore, in the relations between the parties, the corporate social responsibility of the investor should be safeguarded. It is not enough for companies to comply with the law, refraining from causing damage. They must consider in their investment or other costs social responsibility for the technological, economic and environmental progress of the host State. (Pérez, 2016, pp 3). In this context, international regulations are very limited, expressing themselves mainly through soft law standards, insufficient to guarantee the general interest in the host State. (Schreuer, 2010, pp 11). The principles of human rights must be transversal, both to decision-making bodies and to normative production from a state or consensual source. The economic functionality, the basis of foreign direct investment, must be articulated with the protection of those Rights. (Jacob, 2010, pp 3). "Transnational" relations, due to their specificity and interests, make the contractual instruments the pillar of regulation, enhancing the supremacy of business interests. Thus, despite the UN's efforts to include clauses protecting fundamental rights, it is necessary to be more incisive and stronger in including results obligations for the technological, economic and social progress of the population of the host State. It should be noted that the fair and equitable treatment clause has the same meaning as the international minimum standard of treatment afforded to aliens and their property, NAFTA Article 1105 (North American Free Trade Agreement). However, it is necessary to go further by avoiding the discussion about its autonomous guarantee nature, considering criteria of justice, equity and good faith, and respect for human and social rights in presence (Soria, 2015 and Schreuer, 2010, pp 6-7). On the other hand, UNCTAD - the United Nations Conference on Trade and Development - has understood that the standard of fair and equitable treatment is an element of extraordinary importance in foreign investment agreements. Not forgetting that it is the pattern most invoked by investors in investment conflicts (Arenhart, 2013, pp 9). In this context, the introduction of a progress clause appears to be a crucial complement to the rebalancing of the interests of the parties and to serve as a further guiding principle for arbitration tribunals to resolve disputes in this area. It is the obligation of the Contracting States to fulfill their role of defending the general interest in the presence by negotiating the investment agreement / contract. We conclude, citing MEILÁN GIL that "In complying with the legal system, the Administration is serving the general interest specified in the contract. The prerogative, as history and praxis have shown, has not always been exercised in the public interest. Not infrequently it is an imposition that masks the deficiencies of the Administration in the preparation of the contract with the acquiescence of the contractor, exacerbated in times of economic crisis. The abandonment of the prerogative that is proposed is not the triumph of private interest over the public, which is still prevalent, but the triumph of the law in the face of arrogance and corruption." (MEILÁN GIL, J.L., 2013, pp 12)

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## **ECONOMETRIC ANALYSIS OF THE IMPACT OF HUMAN CAPITAL COMPONENTS ON UNEMPLOYMENT**

**Vusala Teymurova**

*PhD in Economy, Associate professor of the Department of "Statistics and Econometrics",  
Azerbaijan State University of Economics (UNEC), Azerbaijan*

**Leyla Huseynova**

*PhD in Economy, Assistant of the Department of "Statistics and Econometrics", Azerbaijan  
State University of Economics (UNEC), Azerbaijan*

### **ABSTRACT**

*The main purpose of the research work is to assess quantitatively the impact of the components of human capital vector upon the level of unemployment in the labor market. So that the econometric investigation has been conducted in order to consider the impact of those components of the human capital vector from the state budget to education and health on the level of unemployment. The various methods of econometric modeling have been used during the study. Econometric testing of built-in regression models has shown that these kinds of models are far more adequate in real-time and can be used to foresee and define unemployment levels within the labor market.*

**Keywords:** *causality, education costs, healthcare costs, human capital vector, stationarity, unemployment*

### **1. INTRODUCTION**

According to the classic approach, the main part of the economically active population of the country does not participate in the creation of goods and services, which engenders an unemployment problem, and becomes a severe challenge for the world economy that directly affects the living standards of the population. Currently, this problem reflects itself as a concrete violation of the balance between the "demand and supply" of the labor force in the labor market. It is an undeniable fact that in contrast to the world practice, the unemployment phenomenon in the labor market of Azerbaijan has a number of peculiarities. Thus, the main complications of the unemployment within the society are specific tendencies such as the deepening of social tension and the lack of sustainable economic security in the country that can be considered relatively stable. On the other hand, there is no direct linkage between unemployment with demographic factors, wave periods in the economy, and transformation processes in Azerbaijan. Therefore, the main source of unemployment in Azerbaijan should be investigated in other platforms by taking into consideration the socio-economic factors. So that one of the vital components of the vector that characterizes this aspect is the role of human capital. Consequently, one of the key priorities of Azerbaijan's socio-economic life and economic security is to determine the place, role and development of the human capital in reducing unemployment.

### **2. THE INVESTIGATION OF THE ECONOMETRIC IMPACT OF HUMAN CAPITAL ON THE UNEMPLOYMENT PROBLEM**

During the process of econometric study of the human capital impact on unemployment, we will consider the impact of two elements of the human capital vector - the level of education and health in the unemployment rate of the country. The core reason is that education is considered a focal factor that directly affects GDP by shaping the knowledge, skills, and capacities of the country's population. Simultaneously, the impact of health on this macroeconomic indicator is unambiguous and cannot be a subject of discussion.