

## Shadow economy in Uzbekistan and measures to reduce it

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**Abstract:** Shadow economy is a complex phenomenon that involves economic activities operating outside the purview of government regulations, taxation, and control. The presence of the shadow economy poses both challenges and opportunities for society. It harms society by reducing government revenue through tax evasion and diverting resources towards the detection and concealment of informal labor. This article explores the different definitions and implications of the shadow economy. It discusses how a cashless economy can help manage price levels and reduce illicit trade and tax evasion.

**Key words:** shadow economy, tax burden, reducing tax rates, digitalization, shadow activity, unemployment, corruption, tax policy, financial literacy, budget.

**Introduction.** The shadow economy is present in almost all countries of the world, regardless of the political system, living standards of citizens and other socio-economic factors. According to an International Monetary Fund working paper (WP /18/17), the average level of the shadow economy among the 158 countries studied between 1991 and 2015 was 31.9 percent of their GDP<sup>1</sup> and due to certain factors this figure varies across regions and countries.

At the same time, the shadow economy in world practice is understood as legal economic activity, with signs of tax evasion and other mandatory payments (concealment of revenue, illegal labor, and others), that is, criminal activity is not part of the shadow economy.



Experts believe that the common causes of the shadow economy for all countries include the tax burden, administrative burden (the difficulty of opening and running a business legally, complying with certain legal standards, labor laws, safety standards and payment of social payments, compliance with administrative procedures), uneven tax burden and complexity of the tax system (tax incentives, exclusive rights for some entities), the quality of government institutions, unemployment, corruption in the government apparatus (as a result of which there is distrust of the population in government institutions), low financial literacy and low tax morale of the population.

At the same time, it is difficult to assess the scale of the shadow economy, since the individuals and businesses in “shadow” by their nature try to remain unnoticed. However, monitoring activity in the shadow economy is extremely important for the following economic and social reasons:

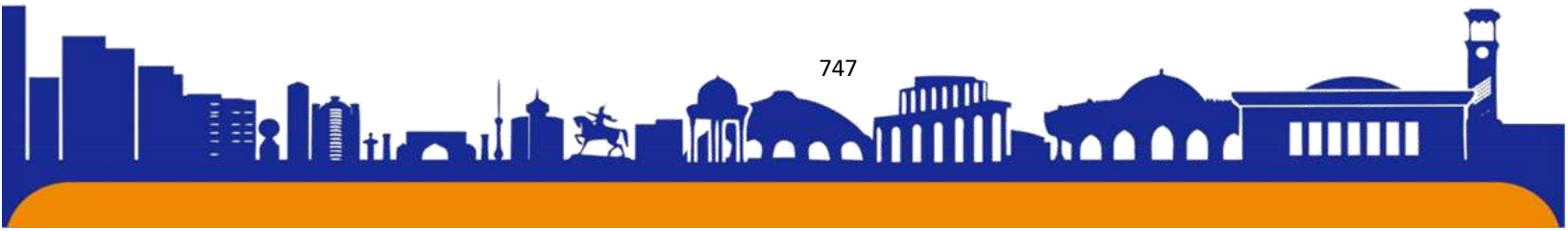
- by regulating economic activity, governments try to create a system that, among other things, protects people from harm (for example, health and safety regulations) and provides certainty for business (for example, legal institutions), allowing the economy to flourish;

- the existence of the shadow economy gives rise to unfair competition, as a result of which subjects of the “white” economy face a higher tax burden (when one business entity pays all taxes and the other does not, an unscrupulous taxpayer has an unjustified tax benefit and the tax burden is reduced at the cost of increasing the burden on all other taxpayers);

- low or complete absence of taxation of shadow economic activities entails a loss of large revenues for the government.

It is worth noting that one of the reasons for lower shadow activity in developed countries is digitalization, since it is one of the main tools for ensuring transparency of transactions, and as a result of correct calculation of taxes. Research shows that the higher the level of IT in a country, the lower the level of the shadow economy.

In Uzbekistan, like in other countries, measures are being taken to reduce the shadow economy. In particular, several legal acts (for instance, Decree of the President of the Republic of Uzbekistan PF-6098 of October 30, 2020), in addition to a lot of changes and additions to the Tax Code have been adopted in order to fight shadow economy.





Many new incentive mechanisms and control measures to prevent business entities from conducting shadow activities, in particular for sectors of the economy subject to high shadow activity.

When assessing the level of the shadow economy in the country using the MIMIC (Multiple Indicator Multiple Cause Model) model, it was determined that, according to preliminary data, the level of the shadow economy in the country reached its maximum in 2020 (60% of the country's GDP) due to mitigations associated with the pandemic COVID-19 and the moratorium on tax audits, which had been in effect since 2017.

It has to be mentioned that this model calculates not only the level of the shadow economy, but also the illegal one, since it is impossible to distinguish them using this model. Accordingly, we can conclude that currently the level of the shadow economy (hidden but legal economic activity) is estimated at approximately 40% of GDP.

According to MIMIC, the beginning of a noticeable growth of the shadow economy in the country occurred in 2018, after the tax moratorium began in 2017. For comparison, if in 2017 the growth of the shadow economy was 1% of GDP, in 2018 this figure was 4%, in 2019 5%, and in 2020 8%.

When a moratorium on tax control measures (mainly tax audits) was introduced, a significant gap in opportunity and compliance emerged as businesses were able to use aggressive measures to avoid taxes with extremely low risk of detection or punishment. Thus, some enterprises developed a feeling of impunity, which influenced the growth of shadow activity.

According to the model, in 2021 the level of the shadow economy in the country sharply decreased by 4%, and a year later there was again a slight increase of 2%, which shows the effectiveness of actions aimed at reducing the shadow economy.

Based on the results of the analysis, we can conclude that the level of the shadow economy in the country remains high, although it is slowly declining.

When analyzing the results, it was determined that in all analyzed countries (Tajikistan, Kazakhstan, Kyrgyzstan and Uzbekistan) from 2009 to 2021, the volume of the shadow economy in relation to the countries' GDP increased, which indicates a trend not only in Uzbekistan, but throughout the whole Central Asian region.

It is noteworthy that even after significant changes in tax policy took place in 2019 (reduction of VAT and property tax rates, equalization of personal income tax, and other changes), which were aimed at supporting businesses (mainly small and medium-sized)





the volume of the shadow economy had not decreased, which in turn suggests that even such an effective mechanism as reducing tax rates is not the main tool in the fight against the shadow economy.

Based on the above, we can conclude that improving IT systems in tax and customs authorities, increasing the financial literacy and tax morale of the population through incentive and punitive measures, expanding employment opportunities for the population and reducing the administrative burden are the most effective measures in the fight against the shadow economy.

With all the above measures, most experts agree that the main tool for reducing the share of shadow activity in the economy is working with the public, namely explaining why and how important taxes and other revenues to the country's budget are. Until tax morale improves among the population and businesses, it is very difficult to reduce the shadow economy.

**Conclusion.** Ultimately, it is necessary to awaken a sense of intolerance towards the shadow economy among the population by explaining the importance of tax and customs revenues to the budget and the incomparability of the small benefit received by each consumer due to the shadow operation with the colossal harm to the economy when this problem is ignored. Each operation in the shadow zone is a loss for the budget of those resources that are necessary to maintain economic and social well-being in the country.

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