KEY DETERMINANTS AND TRENDS OF THE “SHADOW ECONOMY” IN UZBEKISTAN

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Abstract
The shadow economy, as a sign of informal and often illegal economic activity, is a phenomenon that has profound implications for both developed and developing countries. The global landscape of the shadow economy is characterized by its ability to adapt to changing circumstances, and Uzbekistan is no exception. Current trends in the country's informal sector demonstrate a complex pattern of economic activity that often goes beyond formal regulation and reporting mechanisms. From small businesses operating in the shadows to informal operations, the nuances of these trends are explored to provide a comprehensive understanding of the scale and nature of the country's shadow economy. This article examines current trends in the development of the shadow sector in the Republic of Uzbekistan, and examines the main determinants and potential consequences of the shadow economy in the context of the country.

Keywords: shadow economy, determinants, tax burden, state regulation, development of the official economy, smuggling of goods.

Introduction
Trends in the development of the national economy in most countries of the world are characterized by unstable indicators of their economic and social development, imbalances in the economy, budget deficits, low efficiency of government measures, etc. One of the main problems in the functioning of the modern economy is the ever-growing shadow volume of financial transactions. Taking into account the significant influence of the shadow economy on various components of the country's development, the analysis of the essence of the shadow economy and the prerequisites for its formation acquires scientific and practical significance.

In recent years, the country has faced significant challenges related to the shadow economy. This became especially noticeable during COVID-19 pandemic and in the initial stages of lifting quarantine restrictions, when the growth of informal turnover of scarce
goods, in particular medicines, accelerated in the context of a total breakdown of sustainable supply chains around the world. The term "shadow economy" refers to illegal, unofficial and undeclared business operations that take place outside the official system of taxation and state regulation. As for Uzbekistan, as a result of the collapse of the USSR and, accordingly, the command and administrative system, a large-scale shadow economy sector was formed. Market reforms and the liberalization of core activities have failed to change this phenomenon for various objective and subjectivereasons. In the context of fundamental reforms on the way to market relations, the shadow economy is a significant obstacle to the sustainable development of the country’s economy. The problem of the shadow economy, both in the world and in Uzbekistan, has a wide range of consequences that negatively affect various spheres of public life. These include problems with significant losses to the state budget; undermining юридического social equality in society and creating prerequisites for the development of various corruption mechanisms, as well as negatively affecting the business environment and investment attractiveness of the country. The problem of the shadow economy is systemic and requires urgent measures to minimize the risks associated with its sharp growth and high dynamics. In the context of strategic uncertainty in the geopolitical and geo-economic environment in Central Asia, the determinants that determine the level of the shadow economy are only getting worse and they can lead to the growth of the shadow sector to a critical level.

Given the above, high indicators of shadow economies are one of the significant threats to the national security of the state in the economic sphere, so it is relevant to search for the main methods and levers for determining the determinants of the shadow economy and ways to minimize them as important prerequisites for ensuring full-fledged state security through the prism of economically sustainable development of the country.

**Literature analysis and research methodology**

The shadow economy is inherently difficult to measure, as agents involved in the activities of the shadow economy try to remain unnoticed. General economic activity, including the formal and informal production of goods and services, is essential for developing economic policies that respond to fluctuations and economic development over time and space. Moreover, the size of the shadow economy is a key factor for assessing the extent of tax evasion and thus deciding how best to control it.

The shadow economy is known by various names, for example, "hidden economy", "informal economy", "black economy", "fictitious economy", "underground economy". All these synonyms refer to a certain type of shadow economic activity. In practice, the IMF uses the following definition: “the shadow economy includes all economic activities that are hidden from official authorities for monetary, regulatory and institutional reasons". Monetary reasons include tax evasion and all social security contributions; regulatory reasons include

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avoiding government bureaucracy or regulatory burdens; and institutional reasons include corruption, the quality of political institutions, and weak rule of law. Also, shadow economic activity can be defined as such economic activity and income received that circumvents the mechanisms of state regulation, taxation or surveillance.

Initially, in 1939, E. H. Sutherland, an American criminologist, in his work "The question of whether crimes of white-collar people are crimes?", considered the development of the informal economy in parallel with the analysis of large business. Later, this interest in the informal economy was continued by the American researcher G. БекBaekker and the British sociologist K. Kropotkin. Khartoum as part of their research work, where they also drew attention to the development, components and other aspects of the informal economy in society.

The study of the problems of the shadow economy is reflected in the scientific works of many scientists, including: E. de Soto, J. D. Smith, O. Butnik-Seversky, V. Petrenko, Z. Varnali, V. Franchuk, S. Ishchuk, I. Gontarev, V. Pavlov, S. F. Schneider, A. Byun, and others. But despite the large number of publications and their high level of theoretical processing on the problem under study, the issues of determinants, both global and local, which create conditions for the existence of a wide sector of the shadow economy and their impact, as well as ways to eliminate them, remain poorly studied and relevant for our state. Also, many issues related to the shadow economy are controversial and do not have a clear definition.

In the framework of this study, the authors used such methods as: monographic – in the theoretical substantiation of the concept of "shadow economy"; economic-statistical, graphical – in assessing the dynamics of the level of calculation and comparison of indicators among different countries, scientific generalization – in generalizing the features of the influence of the studied determinants on the level of the shadow economy in Uzbekistan. In addition, the MIMIC (Multiple Indicator Multiple Cause Model) calculation methodology was used) The choice of variables is based on the scientific literature, but it was necessary to find a compromise between completeness and availability of data. The variables stored for this analysis are discussed.

The information base of the study was static data of the State Statistics Committee of the Republic of Uzbekistan, other responsible departments, along with data from international organizations, including the World Bank, the IMF and scientific works of domestic and foreign authors, electronic resources presented on the Internet, and the results of the author's own research.

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Results and Discussion
Assessing the extent of the shadow economy is a complex task, due to the fact that participants in this sector tend to maintain their invisibility due to its nature. However, monitoring activities in the shadow economy is becoming important for several reasons. Regulation of economic processes is an attempt by the State to create a system that, among other things, ensures the protection of workers (for example, through health and safety regulations) and provides stability for business activities (for example, through legal institutions), thereby contributing to the sustainable development of the economy. If these institutions are bypassed, economic relationships run the risk of becoming destructive and burdensome. Moreover, the presence of the shadow economy creates unfair competition, as participants in the official sector face higher tax obligations. This, in turn, leads to low tax deductions in the shadow economy, which can mean the loss of potential sources of income for the state budget.

In practice, there are many more methods for calculating and estimating the scale of the shadow economy. The reason for the existence of such a broad methodology is that all these methods represent different quantitative estimates of the shadow economy, and each method of calculating the level of the shadow economy covers a certain area of the national economy (with a correspondingly different share of the illegal sector in it). Currently, an assessment of the level of the shadow economy in the country is being carried out in cooperation with experts from the World Bank, using the MIMIC model. Analyzing the data in Figure 1, in the period from 2000 to 2022, the level of the shadow economy in Uzbekistan ranged from 28.8% to 60%, according to the Ministry of Economy and Finance of Uzbekistan and the World Bank. The level of the shadow economy in the country peaked in 2020 (60% of the country’s GDP) due to easing related to the COVID–19 pandemic and a moratorium on tax audits.

![Figure 1 Level of the shadow economy (relative to GDP,%) in Uzbekistan from 2000-2022.](image-url)

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In 2018, the country recorded a significant surge in the shadow economy, which began after the introduction of a moratorium on tax audits. For comparison, in 2017, the level of the shadow economy amounted to 1% of GDP, while in 2018 this figure increased to 4%, in 2019- to 5%, and in 2020 - to 8%. According to the analysis of the MIMIC model, in 2021 there was a sharp reduction in the level of the shadow economy by 4%, but a year later a small increase of 2% was recorded (Figure 2).

Analysis of the results indicates that the level of the shadow economy in the country remains high, despite its gradual decline.

Figure 2: Dynamics of growth of the shadow economy in Uzbekistan from 2001-2022, as a percentage

An important conclusion is that 2023 may become a crucial year for assessing the effectiveness of measures taken to reduce the shadow economy. After a sharp increase in this indicator since 2017, in 2021 there was a decrease for the first time, but in 2022 the level rose again. This indicates the need for careful consideration and further improvement of strategies and measures taken to contain the shadow economy in a given country.

The lowest level of the shadow economy in Europe, for example, according to World Economics, was recorded in Switzerland, where it reached 7.5%. It can be assumed that this is the "natural level of the shadow economy".

Taking into account the specifics of the Uzbek economy, the following main determinants of the shadow economy can be identified:

Tax burden: This is one of the most commonly used variables for estimating the size of the shadow economy. It is argued that by reducing the return on official labor, taxes stimulate the supply of labor in the shadow economy. Moreover, by raising the cost of labor, taxes can reduce the demand for labor in the formal sector and increase it in the shadow economy. Similar arguments can be made for other types of taxes and government revenue, such as social security contributions. For example, higher sales taxes may encourage transactions in the shadow economy. Thus, an increase in the tax burden is expected to correlate with an increase in the size of the shadow economy. The tax burden is measured as the share of government revenue in gross domestic product (GDP).

Intensity of state regulation: as in the case of taxation, government regulation increases the cost of doing business in the formal part of the economy, which makes activities in the shadow economy relatively less expensive and, therefore, more attractive, according to Friedman, Johnson and other economists. The intensity of state regulation was applied in several ways, but it often turned out to be statistically unrelated to the size of the shadow economy.

Quality of state institutions. The quality of public institutions is another key determinant of the development of the shadow sector. In particular, the effective and discretionary application of the tax code and regulations by the government plays a crucial role in deciding whether to work underground, especially if the country has a poorly developed economy and a heavy actual burden of taxes and regulations. A bureaucracy with corrupt officials tends to involve a lot of informal activity, while a high level of rule of law due to property rights enforcement and contract enforcement increases the benefits of officialdom. According to Transparency International, Uzbekistan ranks 126th out of 180 countries in the Corruption Perception Index (Transparency International, 2022). It is also ranked 78th out of 139 in the Rule of Law index. Therefore, it is an essential determinant of the existence of the shadow sector.

State regulation of the economy. Labor market regulation or trade barriers are another important factor that reduces the freedom of choice for entrepreneurs in the formal economy. They lead to a significant increase in the cost of labor in the official economy, thus creating another incentive for working in the shadow economy. Countries with tighter regulations tend to have a larger share of the shadow economy in total GDP, according to The Global Economy. In some countries of the world, the acquisition and possession of weapons, trade and use of marijuana, and prostitution are legalized for an open economy. Within the framework of this law, there are economic areas in Uzbekistan

14 The World Justice Project® (WJP) https://worldjusticeproject.org/rule-of-law-index/global
that the state could tax, since they exist in the shadow sector. Among them, the following can be distinguished: possession of weapons, use and official trade in certain narcotic drugs. All of them make up a potentially "large blackёрный market"that the state could bring out of the shadows through legalization in the future. By legalizing some activities that may meet rational needs, while eliminating other areas that are designed to meet irrational needs.

▪ State of the labor market. The list of labor market factors affecting the level of the shadow economy includes two main ones: the unemployment rate and the number of self-employed people. There is such a socio-economic pattern: the higher the unemployment rate, the higher the probability of working in the shadow economy, all other things being equal. According to the Committee on Labor and Social Issues of the Legislative Chamber of the Oliy Majlis and the Committee on Budget and Economic Reforms of the Senate of the Oliy Majlis, the unemployment rate in Uzbekistan in 2022 was 8.9%.15 This pattern is due to the fact that quite often the population is counted as unemployed, although it continues its work activity. There are also self-employed persons, which are defined in the tax Code as individuals of working age who, in order to receive labor income, independently and with personal labor participation, perform work and provide services.16 There is a pattern: the more people who are self-employed, the more opportunities they have to perform various activities in the shadow economy, assuming that other factors remain unchanged. The reason for this phenomenon is that it is more difficult to account for self-employed people and track their true reporting.

The main negative consequences of the shadow economy include, firstly, the problem with significant losses for the state budget. Since the shadow economy operates outside the tax system, many business operations remain undeclared, which leads to a decrease in the state’s income and limits its ability to finance social programs, infrastructure projects and other important initiatives. Secondly, the shadow economy undermines equality in society and creates prerequisites for the development of various corruption mechanisms. Informal incomes and transactions contribute to the unequal distribution of wealth, increase social inequality, and contribute to the emergence of illegal money circulation mechanisms and corruption schemes. This undermines citizens’ trust in the State, reduces the effectiveness of public services, and violates the legal system. Third, the shadow economy has a negative impact on the business environment and investment attractiveness of the country. Illegal activities that occur within the shadow economy create uncertainty for businesses, undermine competitiveness and hinder economic development. This becomes an obstacle for foreign investors who could potentially invest in the country’s economy, but face risks and uncertainties associated with the shadow economy. This means that there are very few permanent contracts in the labor market. This, on the one hand, greatly reduces wages due to high competition among workers in the informal sector, and on the other hand, restricts opportunities for career growth and improving well-being. The informal sector helps meet

15 https://stat.uz/ru/ofitsialnaya-statistika/labor-market
the needs of the population, but does not provide opportunities for full development of the country. Moreover, due to the limited legal opportunities for the population and entrepreneurs, strategic planning of their activities will undergo various kinds of fiasco. This increases transaction costs, and instead of expanding and creating more complex production processes, there are a large number of microenterprises engaged in the simplest types of activities.

To reduce the shadow economy, you should:

➢ focus on legalizing the unofficially employed and creating new jobs.
➢ take measures to monitor the transfers of individuals in order to prevent the financing of illegal activities, which include sponsorship of terrorism, illegal arms trade, human trafficking and prostitution;
➢ provide a clear definition of "tax expenditures", implement a system for streamlining tax and customs benefits, and start publishing a report on tax expenditures, as benefits destroy a fair competitive environment and fiscal balance;
➢ ensure that tax and customs inspections are targeted and efficient, and publish the results of these inspections.
➢ develop clear key performance indicators for tax and customs authorities, improve their accountability and interaction with the public, and publish as much data as possible on their activities.

Conclusion

Analysis of the main determinants of the shadow economy in Uzbekistan highlights several key factors. In a highly bureaucratic environment and complex regulatory frameworks, the processes of business, taxation and doing business face challenges that contribute to the growth of the shadow economy. Underdeveloped institutions, lack of transparency, and a low trust environment are also considered determinants that support the shadow economy.

It is noted that changes in the dynamics of the shadow economy have been taking place in Uzbekistan in recent years. This is reflected in the statistics, which show a noticeable increase in 2018, followed by subsequent fluctuations in 2019 and 2020. However, according to the MIMIC model, in 2021 there was a significant reduction in the level of the shadow economy, followed by a slight increase in 2022. These changes emphasize the importance of systematic analysis and forecasting of the dynamics of the shadow economy in the country.

References

2. Economies by Informal Economy Size


