

## THE CONCEPT, CAUSES AND CONSEQUENCES OF THE SHADOW ECONOMY

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**Abstract.** The shadow economy represents a significant challenge for economic development, fiscal sustainability, and institutional quality, particularly in transition economies. This article analyzes the concept, causes, and consequences of the shadow economy

**Key words:** Shadow economy, informal sector, tax evasion, institutional quality, economic development.

**Аннотация.** Теневая экономика представляет собой серьезную проблему для экономического развития, финансовой устойчивости и качества институтов, особенно в странах с переходной экономикой. В данной статье анализируются концепция, причины и последствия теневой экономики.

**Ключевые слова:** Теневая экономика, неформальный сектор, уклонение от уплаты налогов, качество институтов, экономическое развитие.

The shadow economy is a term that refers to the hidden activities of corporate, or the use of power and influence by corporations to evade taxes, regulations, and accountability.<sup>1</sup> The shadow economy is the part of economic activity that is deliberately concealed from the authorities to avoid taxes, regulations, or legal sanctions. The shadow economy can include both illegal activities, such as drug trafficking, money laundering, and human trafficking, and legal activities, such as informal work, undeclared income, and tax evasion. The shadow economy is also sometimes called the underground economy, the black economy, the informal economy, or the non-observed economy.

Participants in the shadow economy can be diverse, ranging from individuals to businesses and organizations. Some common characteristics of shadow economy participants include:

- Lack of formal education or training
- Limited access to formal financial services
- Informal or unregistered business operations
- Cash-based transactions

The shadow economy has far-reaching consequences for labor, capital, and the overall economy. Some of the most significant consequences include:

✓ **Lost Government Revenue and Public Resources.** The shadow economy results in significant lost revenue for governments, as unreported economic activities are not subject to taxation. This can lead to reduced public resources for essential services such as healthcare, education, and infrastructure. According to a study by the International Monetary Fund (IMF), the shadow economy can result in lost tax revenue of up to 10% of GDP<sup>2</sup>

✓ **Distortion of economic data and statistics.** The Shadow Economy: An International Survey

✓ **Regulatory Reforms and Enforcement.** Strengthening regulatory frameworks and enforcement can help to reduce the shadow economy. This can include measures such as:

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<sup>1</sup> <https://fastercapital.com/>

<sup>2</sup> The Shadow Economy: An International Survey

- simplifying business registration processes;
- strengthening tax authorities;
- improving labor inspections.

✓ **Social welfare improvements and labor protections.**

Improving social welfare and labor protections can help to reduce the incentives for individuals and businesses to operate in the shadow economy. This can include measures such as:

- Improving access to formal financial services
- Enhancing labor protections
- Increasing social security benefits

One of the reasons for the low effectiveness of the fight against the underground economy is the lack of a coordination system for combating the shadow economy and economic crime. Currently, the number of agencies responsible for combating the economy and economic crime in the republic is 14, and there is no system for coordinating their activities. In our country, many reforms have been implemented to identify and reduce the scale of the shadow economy, and this urgent problem is on the agenda. In recent years, the decrees of the President of the Republic of Uzbekistan dated October 30, 2020 "On organizational measures to reduce the shadow economy and increase the efficiency of the activities of tax authorities"<sup>3</sup> and dated September 10, 2021 "On simplifying customs procedures and further improving the organizational structure of the state customs service bodies"<sup>4</sup>, the resolution of the Cabinet of Ministers dated March 24, 2022 "On measures to implement the "Tax Administration Reform"<sup>5</sup> project with the participation of the World Bank", the resolutions of the Cabinet of Ministers dated June 20, 2020 "On measures to reduce the share of the "Shadow Economy"<sup>6</sup> in the Republic of Uzbekistan" and other regulatory legal acts have clearly defined tasks related to reducing the shadow economy.

Additional revenues expected to be attracted to the budget due to the reduction of the share of the hidden economy (In Khorezm region), mlrd sum<sup>7</sup>

**1-table**

| <b>№</b> | <b>Sectors</b>        | <b>mlrd sum</b>  |
|----------|-----------------------|------------------|
| 1.       | Agricultural sector   | 88.4mlrd         |
| 2.       | Construction industry | 41.0mlrd         |
| 3.       | Service area          | 4.2mlrd          |
| 4.       | Industry              | 1.2mlrd          |
| 5.       | Other areas           | 65.9mlrd         |
|          | <b>Total</b>          | <b>200.7mlrd</b> |

We can see this table additional revenues expected to be attracted to the budget due to the reduction of the share of the hidden economy. It is predicted that if the share of the shadow economy in these sectors is reduced, the state budget will receive 200.7mlrd soms.

<sup>3</sup> Decree of the President of the Republic of Uzbekistan, "On organizational measures to reduce the shadow economy and increase the efficiency of the activities of tax authorities" October 30, 2020

<sup>4</sup> Decree of the President of the Republic of Uzbekistan, "On simplifying customs procedures and further improving the organizational structure of the state customs service bodies", September 10, 2021

<sup>5</sup> Decree of the President of the Republic of Uzbekistan, "On measures to implement the "Tax Administration Reform", March 24, 2022

<sup>6</sup> Decree of the Cabinet of Ministers "On measures to reduce the share of the "Shadow Economy", June 20, 2020

<sup>7</sup> Khorezm State Tax Administration information

The State Program on the Implementation of the Strategy of Actions in Five Priority Areas of Development of the Republic of Uzbekistan for 2021-2027 in the "Year of Science, Education and Development of the Digital Economy"<sup>8</sup>, approved by the Decree of the President of the Republic of Uzbekistan No. PF-5953 dated March 2, 2020, provides for the implementation of a number of measures to reduce the share of the "shadow economy".

### **Conclusion.**

In conclusion, I would like to say that reducing the shadow economy is certainly not impossible. I believe that this requires a well-thought-out, comprehensively thought-out and then implemented strategy. It is emphasized that the "shadow economy" is a natural phenomenon for transition countries, and it helps them organize the activities of the formal sector, but the long-term existence of the shadow economy negatively affects the development of the country, and appropriate measures are proposed for transition countries to reduce the shadow economy. The Organization for Economic Cooperation and Development has recommended three main areas for reducing the share of the shadow economy: educating taxpayers and simplifying compliance with the law, reducing opportunities for engaging in shadow activities and increasing opportunities for detection, and strengthening social norms. With this in mind, this article will address some organizational and legal aspects of reducing and eliminating the "shadow economy".

The following proposals will help reduce the share of the shadow economy:

- eliminate bureaucratic obstacles through the full digitalization of tax and customs procedures;
- implement regulatory reforms in the field of labor relations, including the introduction of regular compliance monitoring to determine the compliance of labor relations legislation;
- in tax and customs reforms, establish a transparent system of incentives for taxpayers who fully fulfill their tax obligations;
- improve social security systems for employees, and use measures to discourage individuals from participating in the informal economy in order to avoid contributions.

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<sup>8</sup> Decree of the President of the Republic of Uzbekistan No. PF-5953, [march2,2020](http://in-academy.uz/index.php/si)